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—IN THE—

Supreme Court of the United States

OCTOBER TERM, 1915.

THE KANSAS CITY SOUTHERN RAILWAY COMPANY, *Appellant and Petitioner,*
vs.
GUARDIAN TTUST COMPANY, CENTRAL IMPROVEMENT COMPANY, CAMBRIA STEEL COMPANY, and KANSAS CITY SUBURBAN BELT RAILROAD COMPANY, *Respondents.*
No. 85.

REPLY BRIEF OF THE KANSAS CITY SOUTHERN RAILWAY COMPANY, APPELLANT AND PETITIONER.

SAMUEL UNTERMYER,
SAMUEL W. MOORE,
Solicitors for Appellant and Petitioner.

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No. 85.

REPLY BRIEF OF THE KANSAS CITY SOUTHERN RAILWAY COMPANY, APPELLANT AND PETITIONER.

I.

We construe the Trust Company's failure to support the theory on which the court of appeals based its decision of this case as an admission that the court's views on the question of estoppel were unsound.

The significant feature of the Trust Company's brief, as we conceive it, is its *entire change of front*, and its *complete repudiation* of the theory on which the court of appeals rested its decision in each of its two written opinions.

No one can read these opinions without reaching the conclusion that the court's judgment is based upon two main propositions: (a) that the reorganization plan by which the so-called "creditor's equity" was diverted to stockholders

constituted a fraudulent conveyance, and (b) that the Trust Company's participation in the plan did not operate to estop it from basing its action upon the same transaction in which it participated.

The opinions, in characterizing the reorganization, are replete with the expressions "fraudulent in law as to unsecured creditors of the old company," "voidable by its creditors," "void as against creditors," "fraudulent and voidable against the unsecured creditors," "void in equity regardless of the motive with which it was made," "fraudulent and voidable as to creditors," "the inequitable and fraudulent appropriation of the Trust Company's equity in the property to the benefit of its stockholder or stockholders," "a breach of trust fraudulent and voidable as to them," "a transfer fraudulent as to creditors," "the fraud and breach of trust," etc.

Indeed, there could not be a stronger or more conclusive declaration upon this subject than is contained in the language of the court of appeals in its second opinion (210 Fed. 709), as follows:

> The question, however, is not material in the case at bar because the transaction was a conveyance of the property of the Belt Company in fraud of creditors and a breach of trust by the Southern Company, which company, with full knowledge of all the facts, actively participated in the entire transaction and thereby acquired the property of the Belt Company, so that that property and the improvements the Southern Company has made thereon, free from the $1,000,000 Belt mortgage and free from any charge for the expenses which the Southern Company has made thereon, stands in its hands charged with a trust to pay the claim of the Trust Company against the Belt Company which the court may execute by a seizure and sale by its master or receiver.

The court of appeals, after thus reaching the conclusion that the reorganization amounted to a conveyance in fraud of creditors, next proceeds to the conclusion, which we believe to be wholly erroneous, that the Trust Company is not estopped by its participation to maintain the present action.

Our brief on the merits of this case is largely devoted to a demonstration that the position of the court of appeals upon the question of estoppel was erroneous and highly prejudicial to the appellant.

It would be most natural to expect that counsel for the Trust Company would bend their energies to support the position taken by the court of appeals, and that their diligence and astuteness would be employed in reinforcing and giving emphasis to the considerations which form the basis of that court's judgment.

But they, in their wisdom, as we read their brief, in order to escape from the dangerous doctrine of the non-application of the doctrine of estoppel, have *repudiated* and *discarded* the entire theory of a fraudulent conveyance so elaborately worked out by the court of appeals.

They will have none of it. The transaction, they say, was *not* a fraudulent conveyance, and therefore there can be no discussion of the application of the rules of estoppel contended for in our brief.

They now say the plan was an honest one, and the only *fraud* in the case was the refusal of the Southern Company to comply with its contract. They now urge, in support of the decree of the court of appeals, two propositions, both of which were *repudiated as unsound* by the master and by the lower court, and *ignored*, and therefore stand unreversed by the court of appeals, to-wit: (a) that the plan was an express contract, obligating the Southern Company to pay the entire floating debt of all the companies involved, on which the Trust Company can maintain an action at law, as upon a contract made for its benefit, and (b) that the reorganization was a *consolidation* of all the companies involved, *including the Southern Company*, under the Missouri statutes.

This is our understanding of the position of counsel for the Trust Company, for they so state (page 3):

> The Trust Company contends that the plan of reorganization, in addition to making provision for the stocks and bonds of the old companies, contemplated

> and provided for the payment of all the general creditors, and was an honest and lawful plan of reorganization, and the Circuit Court of Appeals so held.
>
> The Trust Company insists that the only fraud in the case was the refusal to perform the promise of the plan and the Circuit Court of Appeals so held.

They say the plan was an honest one, that it never became a dishonest one, and that no action taken under the plan was fraudulent as to creditors (page 86):

> The plan was an honest one in its terms, and it never became a dishonest one for there never was a change in its terms. Nor did any "action taken under the plan become fraudulent as to creditors," so that "the duty immediately devolved upon the Trust Company to elect whether to accept the benefits of the fraudulent scheme, or to retain them if they had been already received," as the appellant contends.

The same position is reiterated throughout the brief, notably at pages 76, 81, 125 and 126.

The unwillingness of counsel to accept the case made for them so elaborately and laboriously by the court of appeals, and to reinforce it and support it by their argument and learning, is so unprecedented as to provoke an immediate inquiry as to its cause.

We believe the explanation of this remarkable change of front is to be found in counsel's profound distrust of the soundness of the views of the court of appeals upon the question of estoppel. Unquestionably, if they had believed that they could sustain the court of appeals on this question, they would have devoted their time and energies in support of the court's opinion in its entirety, without having recourse to the discredited theories of consolidation and express contract.

But counsel have concluded that it is unwise for them to lie in the bed which the court of appeals made for them, and they have accordingly staked their chances of success in this Court substantially upon the two propositions stated above.

This reply brief will be devoted largely to a consideration of these two questions, a discussion of which was not thought necessary in our original brief for the reason that they had been ignored by the court of appeals.

We deny most emphatically the statement in the foregoing quotation from the Trust Company's brief, "and the Circuit Court of Appeals so held," and shall contend that it is perfectly plain from the opinions of the court that it did not so hold.

We also dissent from the statement that, upon the Trust Company's theory of an express promise in the plan to pay all the floating debt of the old companies involved, there could be any *fraud* in the failure to pay any creditor of any one of the old companies. If the obligation to pay existed, then the failure to pay was a default in the performance of an express contractual obligation, and to call this fraud is to employ a meaningless expression.

II.

There is no basis whatever for the extraordinary statement that the entire floating debt of the constituent companies has been paid except only the debt of the Trust Company.

Counsel for the Trust Company, at page 3 of their brief herein filed in opposition to our petition for *certiorari*, said:

> The floating debt of all the constituent companies was paid by the reorganization committee or by the Southern Railway, with the exception of the Trust Company's debt.

In our reply thereto we called attention to this misstatement, saying:

> We deeply regret to be compelled to say that there is not a syllable of testimony in the entire record to support this statement, or from which any such inference can be drawn, or which furnishes any excuse for the statement.

In their brief on final hearing, counsel have seen fit to repeat the same erroneous statement without the slightest foundation except unwarranted and unjustifiable inference, as we shall presently demonstrate. They say:

> Its creditors other than the Trust Company were all paid. (p. 29.)
>
> They (the committee) went on regardless of the estimate and paid every claim except that of the Trust Company. (p. 51.)
>
> In this case the floating debts, save a large balance due to the Trust Company, were paid. (p. 55.)
>
> And, so we repeat, that all the floating debts of the Belt Company were paid, as it was originally intended they should be, except that to the Trust Company. (p. 60.)
>
> And the committee acted accordingly and did buy, pay, compromise or settle all claims except that of the Trust Company. (p. 84.)
>
> The creditors were all paid, save the Trust Company. (p. 128.)
>
> The Trust Company is now the only creditor in the case, and asks only that it be paid as the plan promised and as other creditors were paid. (p. 128.)

At page 55 there is a discussion under the heading, "All creditors, save the Trust Company, were paid, and the Trust Company was paid in part."

We proceed to consider the reasons assigned for this statement, none of which affords the slightest excuse for the assertion made.

(a) The first reason assigned (p. 56) is the following:

> In the first place, the presumption, in absence of evidence to the contrary, is that the floating debts of the constituent companies were paid, as otherwise the payments to the stockholders were fraudulently made.

There is no such presumption. As said by this Court in *Howard* v. *Chesapeake Ry. Co.*, 123 U. S. 222:

> But if, as such purchasers (at foreclosure sale), they thereby became bound to pay all the debts and per-

> form all the obligations of the corporations whose property they bought, it would put an end to purchases of railroads.

It is a matter of common knowledge that every railroad reorganization and foreclosure sale in the history of the country has had the effect of cutting out, to a greater or less extent, the claims of unsecured creditors, where they are not preferential within the principles of equity.

The presumption invoked arises, counsel say, from the assumption that otherwise the payments to stockholders were fraudulently made. The court of appeals held that they *were* made in fraud of the rights of creditors, in which event, by the same token, a contrary presumption would arise. The existence of this peculiar presumption, therefore, cannot be determined until *after* the case has been finally decided by this Court on its merits.

(b) Counsel, not content with this tardy and belated presumption, invoke a second one, as follows:

> Secondly, $1,164,172.56 was in fact paid on account of those debts (Rec. 860), and the presumption is that there was no arbitrary or capricious refusal to pay any debt believed to be just.

Counsel appear wholly oblivious of the master's finding that *these very payments* made by the committee and the Southern Company, aggregating $1,164,172.56, to which reference was made, "in reality consisted of *all kinds of items which the committee deemed necessary to take care of so as to secure absolutely the first mortgage lien* of the properties transferred to the Southern Company." (Rec. 860.)

The purpose of the plan and of the committee in executing it was to pay and discharge "such obligations as the committee might find necessary to discharge *in order to relieve the properties to be included in the Southern mortgage from any liens claimed thereon, or from any interference as a matter of business policy.*" (Rec. 861.)

It appears from the finding of the master (Rec. 870) that

the Trust Company "was well acquainted with the *purposes* of the reorganization scheme and with such knowledge entered into the same," etc. The master refers (Rec. 871) to "the *intimate connection and knowledge* of respondent (the Trust Company), as heretofore shown, with the *practical working out of the reorganization scheme* and the large financial interests it had in the successful carrying out thereof," etc.

The conclusion is irresistible, therefore, not only that there was no intention to pay *all* the floating debt of all the companies, but that there was no arbitrary or capricious selection of the floating debt to be paid. The line was sharply drawn, *as the Trust Company well knew*, so as to include liens, and claims of liens, which the committee thought necessary to take care of, so as to secure an absolute first mortgage lien upon the properties transferred to the Southern Company. No one knew this better than the Trust Company. The record contains 76 pages of letters passing between the Trust Company and the reorganization committee during the reorganization period. (Rec. 870.)

We insist that the Trust Company, as the master says, was well acquainted with the purposes of the reorganization scheme, and *with the purpose and intent of the floating debt provision* to make the lien of the Southern Company's new mortgage an absolute first lien upon all the properties, to the benefit and advantage of all the bondholders of the Southern Company, of which the Trust Comapny was one to the extent of $614,981.50, par value.

The findings of the master show conclusively what was intended to be done, and what was done in fact. There is no room for presumptions.

(c) Attention is called to the statement of the master (Rec. 664) to the effect that the Cambria bill was brought for the benefit of all Belt creditors who might wish to join therein, and that, "so far as this record shows," the only indebtedness against the Belt Company, other than that of the Cambria Company and the Trust Company, was on account of the deficiency judgment rendered in favor of the Provident

Company. Counsel seek to create the inference that there were no other creditors, but here again the facts confound them. The master had under consideration, at the time of making the statement above referred to, the argument of the Trust Company (Rec. 664) that none of the transactions in the second ancilliary bill could be attacked by a *subsequent creditor*. For that reason *alone* the master referred to the claims asserted in the Cambria suit. He did not say there were no other claims. There was no occasion for him to say whether there were other claims.

It is obvious, moreover, that no presumption of the absence of creditors can arise from the fact that no other creditors intervened in this Cambria accounting case, which involved the sifting of from ten to twelve thousand items of account, covering a period of ten years. That was not the forum in which it was to be expected that claims would be asserted.

It is unfortunate that the evidence is not here as to the amount of claims against the mortgagor companies, together with a statement of the amounts that were actually paid so as to thoroughly and conclusively disprove the unwarranted claims made by counsel that all of the floating debt was paid. We may, however, with propriety refer to some of the reported cases where it appears that claims of creditors of the mortgagor companies were asserted against the property or against the Southern Company by intervention, or otherwise.

State Trust Company v. *Kansas City, P. & G. R. Co.*, 110 Fed. 10, in which suits by creditors of the Gulf Company brought against the Southern Company were stayed by order of the Federal Court.

State Trust Company v. *Kansas City, P. & G. R. Co.* (Breuel et al, Intervenors), 120 Fed. 398, in which the claims of unsecured creditors asserted by intervening petitioners in the Gulf foreclosure suit were disallowed.

State Trust Company v. *Kansas City, P. & G. R. Co.* (Westinghouse Air Brake Co., Intervenor), 128 Fed. 129; *State Trust Company* v. *Kansas City, P. & G. R. Co.* (West-

inghouse Air Brake Co., Intervenor), 129 Fed. 455, and *Westinghouse Air Brake Company* v. *Kansas City Southern Railway Company*, 137 Fed. 26, in which claims of a material man were allowed in part and disallowed in part in the Gulf foreclosure case.

Fordyce v. *Bradley*, 111 Fed. 769, in which a claim for personal injuries was disallowed.

State Trust Company v. *Kansas City, P. & G. R. Co.* (Temple et al., Intervenors), 115 Fed. 367, and *State Trust Company* v. *Kansas City, P. & G. R. Co.* (Turner, Intervenor), 115 Fed. 1023, in which it appears that claims for personal injuries arising under the statutes of the State of Arkansas and presented by intervening petition in the Gulf receivership were required by the court to be paid by the Southern Company.

The foregoing cases demonstrate that the Southern Company was resisting all claims asserted against its property acquired at foreclosure sale, or against itself personally, and was only paying those claims which were determined to be prior in lien or superior in equity to the mortgages foreclosed.

It appears incidentally in the record that other claims of creditors were being asserted by virtue of intervening petitions in the foreclosure suits, as is the customary practice. It appears (Rec. 775) that the account of the Belt Company against the Gulf Company for $133,000 is still pending before the master as an intervening petition awaiting determination of this case. It also appears (Rec. 688) that the Arkansas Construction Company filed an intervening petition in the Gulf receivership "claiming large sums due them for construction work upon the Gulf road," and that one De Goeijen (Rec. 689) held a claim amounting to $407,478, of which $280,000 was covered by an intervening petition in the Gulf receivership case. It appears (Rec. 689) that the Southern Company settled with the Arkansas Construction Company, paying it the sum of $350,000, and that it settled with De Goeijen, paying him $150,000.

It also appears from the Trust Company's answer (Rec. 466) that the Southern Company, after the reorganization, paid to the Provident Company certain real estate mortgage notes, secured at the time of the Belt receivership by a lien on the property of the Belt Company, aggregating $89,333.33.

It thus appears from the record, as well as from the reported cases, that the Southern Company, so far from paying all of the unsecured obligations of the reorganized company, was resisting their payment, except to the extent that such claims were of a *preferential nature;* that the payments above mentioned were all of liens, or lien claims, all of which was in complete harmony with the master's finding as to the purpose of the floating debt provision and the manner of its execution.

Counsel assert in their brief, p. 62, that the committee purchased the stocks of the Union Terminal Company and of the Air Line "in recognition of the validity of the Trust Company's claim." The transaction does not justify any such inference. As appears from the master's report (Rec. 769-770), the committee needed the Air Line and Union Terminal stocks, which were then held by the Trust Company as collateral security, in order that these stocks might be pledged under the new mortgage of the Southern Company. The stocks had no real value, but nevertheless the Trust Company required the committee to pay to it $35,000 for the shares. The master says:

> These Air Line and Union Company stocks were acquired by the committee for the Southern in order that the latter might be able to include such stock in its general mortgage as further security to the new security holders or bondholders thereunder. (Rec. 770.)

The committee was compelled to secure these stocks in order to carry out the plan, for at that time, June, 1900, those two companies could only be brought under the new Southern mortgage through the pledge of their securities. Nothing was further from the mind of the committee in conducting this

transaction than a recognition of the validity of the Trust Company's claim.

The Trust Company, in its petition against the Southern Company filed in the state court in 1905 (Rec. 505), charges that the reorganization committee

> did sell bonds issued by defendant of the par value of $3,000,000, and its preferred stock of the par value of $3,000,000, and realize thereon over $3,000,000 in money; that out of the proceeds of said sale said committee paid such floating debt of the Belt Company as it chose to pay and made such disbursements as it saw fit to make, and paid over the balance to defendant, said balance amounting to several million dollars and being greatly in excess of the *entire floating or unsecured debt of the Belt Company.*

The petition further alleges (Rec. 506) that a settlement was had between the committee and the Southern Company in October, 1900, and

> said committee turned over to defendant the cash remaining on hand after making the disbursements aforesaid, the amount of which was greatly in excess of the *entire floating or unsecured debt of the Belt Company.*

Substantially the same allegations are made (Rec. 522) in respect to "the entire floating or unsecured debt of the *Belt and Dock Companies.*"

Again, substantially the same allegations are made in its petition filed in 1906 (Rec. 539), in respect to "the entire floating or unsecured debt of the *Gulf Company.*"

It appears, therefore, that as late as 1905 and 1906 the Trust Company, so far from asserting its present claim that all the floating debt except the Trust Company's debt had been paid, solemnly asserted and reiterated the existence of "the entire floating or unsecured debt of the Belt Company, the Dock Company and the Gulf Company."

Counsel insinuate in their brief, pp. 48, 60, that the indebtedness of the Cambria Company has been taken care of. We deny this most emphatically.

It is worthy of note that nowhere in this record, in any one of the six answers that the Trust Company was "compelled" to file, nor in any exception, master's report, or in the opinion of any court, does there appear to have been a claim made, such as is now put forward at the eleventh hour, that all of the debts of the reorganized companies, except that of the Trust Company, have been paid by the committee or by the Southern Company.

It is not at all material to a determination of the issues herein whether the Southern Company has paid, settled, or compromised any of the floating debt of the reorganized companies. The sole question is whether a legal obligation exists to pay the debt of the Trust Company. We have gone into the matter, perhaps at too great length, for the purpose of demonstrating conclusively that the Trust Company, in its effort to bolster up its case, has felt compelled to resort to statements which have no foundation of fact upon which to rest, the only apparent purpose of which is to create the misleading impression in the minds of the court that the Trust Company has been a victim of discrimination or hostility, and that it has been singled out for unfair treatment. Most emphatically this is not the case. There has been no discrimination and no favoritism of any kind whatsoever.

III.

The claim of the Trust Company that it is not barred because participating in the plan as bondholder and stockholder.

The Trust Company, as before stated, is unwilling to rest its case upon the theory of a fraudulent diversion of the "creditor's equity" so elaborately worked out by the court of appeals and so strongly supported in principle by the Boyd case. In its brief it refers to this theory casually, as a matter to be noted in passing, but does not invoke it as a ground of recovery. Likewise, the observations of the court of appeals upon

the subject of estoppel *in pais*, without which we contend the decree of that court would have been in favor of the Southern Company, are passed over in silence. Instead of endeavoring to uphold, support, and reinforce the position of the court of appeals, the Trust Company is content to allow that court, with its pronounced views on fraudulent reorganizations and estoppel *in pais*, to shift for itself, while it has recourse to other theories, already more or less discredited in this litigation, for the support of its decree.

Counsel "find it unnecessary to consider the distinction between estoppel and *quasi*-estoppel." (p. 86.) They insist that the plan was an honest one; that it never became a dishonest one, and that no action taken under the plan became fraudulent as to creditors. (p. 86.) They insist that the plan was one "which dealt fairly with bondholders, stockholders, and creditors, and dealt equally with the members of each class." (p. 76.)

The Trust Company is at last forced to a recognition of the fact that it cannot "grasp the benefits of a contract with one eager hand, while thrusting aside its burdens with the other." (*St. Louis* v. *Davidson*, 102 Mo. 149.) It cannot claim a fraudulent diversion of the "creditor's equity" while it has in its treasury a goodly share of the proceeds of the same transaction. It must needs, therefore, abandon its charge of fraud, and with it, the aid and comfort furnished by the opinions of the court of appeals; and as a last resort, it now boldly stands upon the plan of reorganization, and openly claims that the plan is a contractual obligation to pay all floating debt in full, or that it created a statutory consolidation of all the companies involved. Obviously, if there is no fraud, then there is no estoppel to claim fraud.

If the plan of organization was an enforceable contractual obligation to pay *all* the floating debt of the companies involved, then *that fact* is decisive of this case, and there is no necessity or excuse for arguing or considering the distinction between estoppel and *quasi*-estoppel. That the plan was *not* such a contract is elsewhere considered.

Counsel assert (p. 79) that participation in the plan according to its terms involved no inconsistency and required no election on the part of anyone who was alike bondholder, stockholder, and general creditor; and they ask the question:

> What difference does it make, when we are dealing with the same plan that one person was alike bondholder, stockholder and creditor?

And they argue that a creditor who was also a stockholder could sell his stock, and that then both must be paid.

It is doubtful if this could be done, since the only value the stock could then have would be its right to participate in the reorganization and to receive in exchange the stock in the new company, and it was held in the Wormser case, 184 N. Y. 83, that a sale of such rights was such a participation in the reorganization as created an estoppel to claim that the plan was fraudulent or to base an action thereon.

However that may be, the law is plain that a different rule *does* apply to one who is *both* creditor and security holder, as this Court expressly decided in *Bank of Ft. Madison* v. *Alden*, 129 U. S. 372. There, eight persons, two of whom owned the Bank of Ft. Madison, organized a lumber company and transferred timber lands to a trustee for it in payment of stock subscriptions, and received their allotted shares of stock in the company. The Lumber Company afterwards became indebted in a large amount to the Bank of Ft. Madison and, becoming embarrassed financially, caused the timber lands to be reconveyed to the stockholders who originally owned them. The Bank of Ft. Madison sought to enforce its debt against the Lumber Company by action against the stockholders. The contention of the bank is thus stated by the Court:

> It is contended that the lands, which in the hands of the trustee constituted a *trust fund for the benefit of the stockholders and creditors of the company*, were not divested of their trust character upon their reconveyance to the stockholders; that the only effect of the reconveyance was to substitute several trustees in place of one; and that the appellant has therefore a right to proceed against either or all of them for an accounting.

But it was held that the bank (which was owned by two of the stockholders) occupied the dual relation of creditor and stockholder, and for that reason, was not entitled to maintain the action, this Court saying:

> If this were a suit by a creditor *other than a stockholder* there would be great force in this position of the appellant. It might be well contended that a conveyance of the trust fund to the stockholders upon their resolution could not deprive a *creditor*, not consenting thereto, of his right to compel the application of that fund to the payment of his demand, or of a ratable proportion with other creditors. *But the right to compel such application cannot be invoked by a stockholder consenting to such disposition of the trust fund, and himself participating in its appropriation, as in the present case.* Here the lands conveyed to the trustee were subject, as stated above, to a mortgage of $75,000, and its payment was assumed by the company. It turned out that the company was not prosperous in its business, and in the year following its organization it became involved in litigation, and a receiver of its property and effects was appointed. And in April, 1880, its stockholders upon consultation came to the conclusion that it would be impossible for the company to comply with its engagements to pay off that mortgage, and they therefore advised, and at their meeting resolved, that the lands should be reconveyed to the original owners, and the company be thus released. The bank, through its stockholders, who were also stockholders of the lumber company, *united in this advice and resolution*, and in pursuance thereof the several reconveyances were made, as stated above, and among others to the stockholders of the bank. It was expected that the original owners would then hold the lands as they had held them before the lumber company was organized. That the property when reconveyed was sold by the holders at prices which, if the company could have obtained them, would have made its retention advisable, does not alter the transaction.

The Court then refers with approval to *Thompson* v. *Bemis Paper Bag Co.*, 127 Mass. 595, the facts of which are well stated in the syllabus as follows:

A made a contract with B for the purchase of a certain number of shares of the capital stock in a corporation, and paid part of the agreed price; but the stock was not then transferred to him. While the stock stood in B's name on the books of the corporation, A attended meetings of the corporation and voted as a stockholder. At one of these meetings, a vote was cast to divide the cash assets among the stockholders, A voting the affirmative. After this, a settlement was had between A and B, the stock transferred to him, and he was credited with dividends received, including that from the withdrawal of the cash assets. A then brought an action against the corporation for a debt due from it to him, recovered judgment, and, the corporation neglecting to pay for thirty days after a demand duly made upon it, brought a bill in equity, under the St. of 1870, c. 224, Sec. 42, to enforce the personal liability of the other stockholders on the ground of the withdrawal of the capital stock while there were debts outstanding. *Held*, that the bill could not be maintained.

The opinion of the Court, which was delivered by Chief Justice Gray, is as follows:

A creditor who is *also* a stockholder of a corporation, and as such liable for its debts, is not entitled to the remedies afforded by statute to creditors against stockholders for the debts of the corporation. *Thayer* v. *Union Tool Co.*, 4 Gray 75; *Potter* v. *Stevens Machine Co.*, *ante* 592. The mere fact that the plaintiff was the equitable owner of shares might not indeed subject him to the liabilities or disabilities of a stockholder. *Crease* v. *Babcock*, 10 Met. 525; *Johnson* v. *Somerville Dyeing & Bleaching Co.*, 15 Gray 216.

But this plaintiff, at the time of the commencement of the suit in which judgment was rendered against the corporation, was the absolute legal owner of eight shares; and even at the earlier period before the passage of the vote on which this bill is founded, he was not only the equitable owner of these shares then standing in the name of Warren, but he was treated by the corporation, and acted, as the legal owner thereof, receiving notices of and attending meetings as a stockholder; he *participated* in the vote by which the whole cash assets of the corporation

were withdrawn, and paid to the stockholders in proportion to the amount of the stock held by each; *and he received through Warren his share of the money so paid out.* He now seeks to make the *very act* which he, as a stockholder, took part in bringing about, and in reaping the benefit of, the ground for charging Warren and other stockholders with personal liability upon a bill in equity under the St. of 1870, c. 224, Secs. 39-43, for a debt due from the corporation to himself. This cannot be permitted.

In the following cases the same person was both creditor and stockholder, and that fact disabled him from asserting his rights as creditor:

Cunningham v. *Holley*, 121 Fed. 720.
Whitehill v. *Jacobs*, 75 Wis. 474.

Counsel argue (p. 82) that there was a "reserve" of Southern securities issued under the plan, or their proceeds, amply sufficient to pay all floating indebtedness of the reorganized companies and, in particular, the indebtedness of the Trust Company. Leaving out of view for the moment the fact that there is nothing in the record to indicate the extent of the floating indebtedness which would thus be included, and also the fact that this argument has not the slightest bearing upon the question of the *legal liability* of the Southern Company, we proceed to examine the Trust Company's contention.

At page 47 of their brief they set out the committee's estimate of probable amounts necessary to pay car trust obligations, floating debts, receivers' certificates, coupons, working capital and expenses of reorganization, aggregating $5,900,000 —the cash requirements of the plan. On the same page they state that the amounts actually paid, *exclusive of working capital and expenses of reorganization*, were $5,070,210.11, thus leaving in round figures $830,000 for working capital and expenses of reorganization, the estimated amount of which, under the plan, was $2,150,000. They also call attention to the fact that there remained $582,500 par value of preferred stock, or $438,750 of common stock, not designated for any particular use.

The practical effect of the Trust Company's insistence is that the estimated amount of $2,150,000 for working capital and expenses of reorganization, already reduced to $830,000, should be still further reduced or entirely wiped out by the payment of floating debt, and that the unappropriated securities should also go the same way.

But if the estimate of $475,000 for payment of floating debt was a trust fund which could not be violated or diverted to any other use, although it might be increased, if necessary, as counsel contend, equally so was the estimate of $2,150,000 for working capital and expenses of reorganization. If creditors of the old companies had the right to sue the Southern Company for their debts under the floating debt estimate, so would the new creditors of the Southern Company, who became such within the working capital provision, be entitled to maintain their actions against it upon that provision; and likewise, the reorganization committee, its counsel, its depositaries (which included the Trust Company), receivers, officers of court, etc., etc., would be entitled to bring suit against the Southern Company for their services, under the estimate for expenses of reorganization. They would have the right to say, as the Trust Company does here, that the estimates for other purposes should be diminished or wiped out but that the estimates for *their* purposes should remain inviolate, except that the estimate might be increased at the expense of some other fund if necessary.

The amount actually paid for floating debt exceeded the estimate by $689,172.56 which was much more than the value of the preferred and common stock not designated for any particular use.

What right has the Trust Company to say that there was a reserve fund sufficient for all of the unsecured creditors when the effect of this insistence is to reduce or entirely wipe out other estimates of equal dignity and importance for working capital and expenses of reorganization?

Counsel also seek to appropriate for their purposes, bonds of the par value of $3,802,500, reserved for future require-

ments of the company, which included "such extensions, betterments, and new equipment as might be required by the business of the company." (Rec. 820.) If counsel are correct in their contention, then not only was this reservation of bonds a sacred fund reserved for the payment of the contractors, workmen, vendors of equipment, etc., who should provide the future improvements, but it was not intended as a *limitation* on the amount which might be used by the committee or the Southern Company, but the deficit, if there should be one, might be made up from the other estimates, including the estimate for the payment of the floating debts which might thereby be materially reduced or entirely wiped out.

These considerations demonstrate the entire incorrectness of counsel's contentions.

IV.

The reorganization plan and agreement do not constitute a contract for the payment of the floating debt of the constituent companies.

This question of the liability of the Southern Company under the "floating debt" provision of the plan is considered by the master (Rec. 854-862), and he reaches the conclusion, which was concurred in by the lower court, that there was no liability under that provision, and his conclusions were not reversed by the court of appeals.

No exception was taken by the Trust Company to the master's conclusion in this respect, the only exception being that the master "should have omitted reference to or recommendation concerning the liability of the Southern Company for the floating indebtedness of the Belt Company" (Rec. 893). We insist that the question of the liability of the Southern Company, by reason of the floating debt provision of the plan, is not properly here for review, for the reasons stated in our brief, pages 167 *et seq.*

In its first opinion, in answer to our claim that the Trust Company, by its exchange of securities, was estopped to

maintain its action, the court of appeals said (201 Fed. 832), referring to the floating debt provision of the plan:

> The Trust Company may well have *supposed* that its claim would be paid by the committee.

But this position was abandoned in the second opinion, and, as the opinion itself shows, no significance whatever, except as bearing on the estoppel question, was attached to the floating debt provision. It is nowhere held that a right of recovery could be based thereon.

But now, in its brief on the merits in this court, the Trust Company not only insists that the plan was both "an honest and lawful plan of reorganization," in repudiation of the court of appeals' theory of liability, but puts forth the claim (p. 44, *et seq.*) that the plan of reorganization provided for the payment of all the unsecured debts of the old companies, and that this was a contract on which the Trust Company is entitled to maintain its action.

Let us consider, first, whether the floating debt provision amounts to a *contract.*

The plan was dated Philadelphia, November 7, 1899, and was addressed: "To the holders of the bonds and stocks of the Gulf, Belt, Union, Consolidated, Air Line, and Port Arthur Channel & Dock Companies," and the plan and the agreement were to be read together as one and the same instrument (Rec. 814). The plan provided for "the payment of the floating debt" (Rec. 815), and made a tentative estimate or appropriation of $475,000 "for payment of floating debts" (Rec. 820). The payment of the floating debt was to be made "from the proceeds of the disposition of the new securities" (Rec. 821), as set forth in the statement in our brief, pages 15-19.

The agreement gave to the committee a broad discretion in respect to the payment of the floating debt, and *authorized* the committee to pay "such indebtedness as, in their judgment, was necessary or expedient in furtherance of the purposes of the reorganization plan and agreement" (Rec. 859).

It also contained the following provision:

> But no estimate, statement, or explanation, or suggestion, contained in said plan or this agreement, or in any circular issued by the depositary or by the committee, is intended or is to be accepted as representation, warranty, or condition under this agreement (Rec. 822).

The master says (Rec. 854), in respect to the power of the committee to alter or modity its terms:

> The reorganization agreement gave the committee plenary power to *alter or modify the terms* as might seem necessary or desirable.

The agreement also contained a covenant in the twelfth paragraph (Rec. 823), the substance of which (210 Fed. 712) is as follows:

> No right is conferred nor any trust, liability, or obligation is created by this agreement or the plan, or is assumed hereunder by or for any new company, in favor of any creditor or any holder of any claim whatsoever against the said companies (including the Belt Company), with respect to any moneys paid to or received by the committee, or with respect to any property acquired by purchase at any foreclosure sale, or with respect to any other matter or thing.

What, at that time, was the situation of the parties? Valuable railroad properties had become hopelessly insolvent, and their reorganization was imperatively necessary in order to prevent a loss of their transportation service to the public, as well as to prevent great pecuniary loss to investors. A plan of reorganization was prepared by the interested parties, which was intended to preserve the interests of bondholders as nearly as might be in proportion to their value, which should preserve, to a certain extent, the interests of stockholders upon the condition (as to the majority of them) that they should pay cash assessments to raise funds necessary to make the reorganization possible, and which should make provision for the claims of such unsecured creditors as

it was necessary to take care of in order to give strength and value to the securities of the new reorganized company. The plan had been preceded by the agreement, by the terms of which the depositing stockholders invested the reorganization committee with plenary power to formulate a plan, to modify it at any time, to shape and alter the details of reorganization as might become necessary, to incorporate a new company, to issue new securities, and, in short, to do anything necessary or advisable in their discretion to work out a desperate situation for the common good.

It was necessary in this case, as it is in all similar cases, that the committee should give to the depositing security holders as much general information as was consistent with conditions which they were called upon to meet, and which might change and vary from day to day, or even from hour to hour. It was obviously necessary to give to depositors all available information as to the capitalization of the new company, the securities which it was to issue, and the disposition of the securities and their proceeds. This was essential in order that the depositing security holders might be able to elect whether to come in under the plan or to act independently of it.

The committee sought to give this information to the depositing security holders by formulating and promulgating the plan of November 7, 1899, with the distinct statement, as above set forth, that it was *subject to modification* by them; that the statements in it were *not* representations or warranties, and that it did not create any obligation or trust or liability *in favor of creditors* or others.

Certain of the securities were to be appropriated for exchange for the securities of the old companies. The proceeds of the remaining securities were "ear-marked" (but not specifically appropriated) for the payment of car trusts which were liens on equipment, for payment of receivers' certificates which were liens on the property, for payment of first mortgage coupons which were also liens, for the payment of floating debts which the master finds were understood by the

Trust Company to mean liens or claims of liens, and for working capital and expenses of reorganization.

There was no fixed or definite or unalterable appropriation of funds for *any* of these specific purposes. They were *estimates* of the amounts which the managers thought would be devoted to those purposes. The purpose was, as said by the master (Rec. 854), "to advise the depositing security holders of the *probable disposition* of the moneys to be realized from the securities to be issued by the new company."

How can it be plausibly claimed that these elastic provisions of the plan and agreement, subject as they were to modification by the committee, and intended only to advise depositing security holders of the *probable* disposition of the new securities, possess the certainty of a contract? How can it be argued that they created a *fixed obligation* to pay all of the floating debt of all of the companies, as the Trust Company now insists was the case?

Let us put the so-called contract into legal form (ignoring for the moment the master's finding that the floating debt provision referred only to unsecured claims which were, or might become liens on the property), for the purpose of showing the weakness of the Trust Company's contentions:

> The bondholders and stockholders hereby enter into the following agreement with the committee:
>
> 1. The committee hereby sets aside $475,000 for the payment of the floating debt of the old companies; provided, that the committee reserves the power to *alter and modify* the terms hereof as in its discretion it may deem necessary or desirable; provided further, that this estimate of the amount to be paid on account of the floating debt is *not* to be accepted as a representation, warranty, or condition; and provided further, that it is distinctly understood that by this agreement no right is conferred, nor is any liability assumed by, or obligation imposed upon the new company in favor of any creditor.

Surely no person will seriously contend that the foregoing agreement constituted a contract which could be enforced in court. The utmost that could be said for it would be that

it was an undertaking by the committee to use its judgment and discretion in using the proceeds of securities in such a manner as would, in its judgment, best promote the interests of stockholders and bondholders.

The Trust Company's position possesses less strength than that of the second mortgage bondholders in *Robinson* v. *Ry. Co.*, 135 U. S. 522, where, pending the reorganization of several railway companies, there was organized a committee of first mortgage bondholders, and also a committee of second mortgage bondholders. The two committees entered into an agreement for the mutual participation of first mortgage bondholders and second mortgage bondholders in the reorganization, which is thus described by the court:

> On the 19th day of June, 1884, the two committees met, and it was agreed between them that the second mortgage bondholders should participate in the reorganization, and should rank therein substantially as they ranked previously, subject to a fair division of expenses, it being understood that a plan of reorganization should be submitted, and that the committee of the first mortgage bondholders should purchase the property at the sale. The railroad and property were sold on the 28th of June, 1884, in pursuance of the decree, and the defendant Coombs, acting for the committee of the first mortgage bondholders, purchased the same for $500,000, and, as the plaintiff assumed and had reason to believe, for the benefit of both classes of security holders.

The first mortgage bondholders appropriated all the property to their own benefit and excluded the second mortgage bondholders from any participation therein, and thereupon plaintiff, bringing his action for all the second mortgage bondholders, brought suit to set aside the foreclosure sale, or, in the alternative, to charge the property with a trust in favor of both classes of bondholders, as provided in the contract above referred to.

It was held, however, that the second mortgage bondholders were not entitled to relief, the court saying:

> The alleged agreement is too vague and indefinite to furnish a foundation for its enforcement. On the showing of the bill the parties never entered into any contract, and the court would have to make one for them. There was no mutuality in the agreement alleged, and no adequate consideration for it is stated or can be imported. These same considerations show that the agreement cannot be adjudged to create a trust for the benefit of the second mortgage bondholders.

The Trust Company, in executing the agreement, consented that the same might be modified by the committee in its discretion, and that fact in and of itself *destroyed* its status as a contract. The committee could have increased the estimate to double the amount, or have reduced it, or eliminated it altogether, and the Trust Company would have had no right to complain.

The Trust Company likewise, by the signing of the agreement, covenanted that the agreement itself should not create any trust, liability, or obligation, in favor of creditors, or against the new company, and this fact in and of itself bars the Trust Company from claiming that any obligation was created *by the plan* in its favor. The position of the Trust Company (p. 69) is that "no right existing *independently* of the agreement is disavowed or renounced (by this covenant)." This is an implied admission of the obvious fact that rights which otherwise might be *created* by the covenant are, in fact, disavowed and renounced by it. Certain it is that where the Trust Company relies upon the plan and agreement for the *creation* of a liability in its favor to pay the floating debt, all limitations imposed by the plan and agreement itself must be given effect.

In signing the agreement, the Trust Company also assented to the provision that no estimate, statement, explanation, or suggestion contained in the plan should be accepted as a representation, warranty, or condition, and this fact likewise operated to destroy the right of the Trust Company to treat the plan and agreement as a contract.

The very purpose of this provision was to advise all concerned that the estimates, statements, explanations and suggestions contained in the plan were subject to modification or even cancellation, and that no person should be misled by relying upon them as fixed or definite representations or warranties. It would have added nothing to the legal effect if the agreement, in lieu of the statement above referred to, had carried the express language, "the Trust Company is not entitled to consider the floating debt provision as a contractual obligation, since it may be modified, increased, decreased or even eliminated altogether, in the discretion of the committee."

The Trust Company also knew that the floating debt provision was intended to free the property from liens or claims of liens, and that its claim was not of that nature.

V.

The floating debt provision, as the Trust Company well knew, contemplated only the discharge of liens or claims of liens so as to make the Southern mortgage an absolute lien, and the Trust Company's claim was not of this character.

We are not left in doubt as to the precise meaning of the floating debt provision contained in the plan. The master, reciting the testimony of the members of the reorganization committee, says (Rec. 860):

> That the $475,000 appropriated, as above stated, for the payment of floating debts, was a lump sum set aside by the committee to make provision for the payment and discharge of such obligations as the committee might find necessary to discharge in order to relieve the properties, to be included in the Southern mortgage, from any liens claimed thereon or from any interference as a matter of business policy, and that said $475,000.00 was simply an estimate or reservation to cover such charges.

There is no countervailing testimony in the record.

Counsel insist (p. 53) that there is no finding of this fact by the master. This is incorrect. The master (Rec. 860) said, in speaking of the large expenditure in payment of what are called the floating debts:

> —but which in reality consist of all kinds of items, which the committee deemed necessary to take care of, so as to secure absolutely the first mortgage lien on the properties transferred to the Southern Company.

This was the finding of the master. There was no exception to the finding.

The master says (Rec. 859):

> The committee was fully authorized to do as they thought best in respect to paying off such indebtedness as, in their judgment, was necessary or expedient, in furtherance of the purposes of the reorganization plan and agreement.

Again, the master states (Rec. 856):

> Nor does the evidence in the record show that it (the Trust Company) ever changed or altered its position in any way on account of said floating debt provision.

It must be accepted, therefore, as conclusive in this case, from the finding of the master, based not only upon the plan and agreement itself, but upon all the oral and documentary testimony in the record, that the purpose and intent of the floating debt provision of the plan was to remove liens and claims of liens so that the mortgage of the Southern Company would be an absolute first lien; that the committee was invested with a wide discretion in carrying out this provision, and was authorized to pay as much or as little of unsecured claims as, in their judgment, was best calculated to promote the reorganization.

Nor can the Trust Company plead ignorance that such was the purpose of the plan, for the master, with 76 pages of letters between the Trust Company and the committee before him (Rec. 870), says:

> The respondent was *well acquainted with the purposes of the reorganization scheme*, and with such knowl-

edge entered into the same, depositing its own securities and exchanging them for the new Southern securities, and advising others to make like changes.

The master also refers (Rec. 871) to:

> The *intimate connection and knowledge* of respondent with the *practical working out of the reorganization scheme* and the large financial interests it had in the successful carrying out thereof.

The conclusion is irresistible not only that the sole purpose of the floating debt provision was to remove liens and those claims which might ripen into liens against the property to be embraced in the Southern mortgage, so as to give value to the Southern securities for the protection of those who should become their owners (which included the Trust Company), but that the Trust Company was *well aware* of this purpose, and that it, with such knowledge, took the benefits of the plan. It knew then, and it knows now, that its claim is not one of the class which it was contemplated would be taken care of under the floating debt provision. We are at a loss, therefore, to understand how the Trust Company, in view of the findings of the master, can base any claim on the floating debt provision.

VI.

The finding of the master that the committee did not, directly or indirectly, agree to pay, in whole or in part, any of the indebtedness of the Belt Company to the Trust Company, is conclusive against the claims of the Trust Company with respect to the floating debt provision.

The master finds that there was no promise or agreement by the committee, or by the Southern Company, to pay the Belt debt to the Trust Company. He says (Rec. 862):

> The alleged liability of the Southern Company arising on account of any promise or agreement by either the committee or the Southern Company, to pay the Belt debt to the Trust Company, is not satisfactorily supported by the proofs in the record.

And again (Rec. 866) the master says:

> There is no sufficient evidence in the record of the making of any legal agreement, or even of an attempt to do so, by the reorganization committee, or by any person authorized to represent them, or by the Southern Company, by which the Belt indebtedness to the Trust Company would be discharged, either by the committee or by the Southern Company.

And again the master, referring to the minutes of the reorganization committee (some 364 pages) says (Rec. 864):

> It will be seen that at no time did the committee, either directly or indirectly, ever agree to pay, in whole or in part, any of the indebtedness of the Belt to the Trust Company.

This finding is directly responsive to the charge that the committee promised to pay the Belt debt, made by the Trust Company in its answer (Rec. 311) as follows:

> Further answering, this respondent shows that said reorganization committee, when working out said plan of reorganization, expressly represented to this respondent that, in consideration of the debt due and owing from said Belt Company to this respondent, said committee would provide for the payment of all debts and obligations due to this respondent from all of said corporations proposed to be included in said reorganization plan, and particularly said Belt Railroad Company, and *expressly promised* this respondent that said committee would pay, or cause to be paid, all debts of every character due to this respondent from said several corporations proposed to be consolidated, and particularly from said Belt Railroad Company; and that the said new and reorganized company would pay such debts; that certain members of said reorganization committee, constituting a so-called purchasing committee, purchased at the foreclosure sale of said Kansas City, Pittsburg & Gulf Railroad Company all its assets, right-of-way, rolling stock, etc., and thereafter assigned said bid to said Kansas City Southern Railway Company, which said company entered into a contract with said reorganization committee wherein and whereby it assumed and agreed to complete and carry out all the obligations

undertaken and assumed by said reorganization committee; that under and by reason of said agreement and contract said Kansas City Southern became liable and agreed to pay all the obligations of said Belt Railroad Company to this respondent, and is still so liable.

The finding made by the master that there was no promise or agreement on the part of the reorganization committee or of the Southern Company to pay the indebtedness of the Belt Company would include an express promise as well as an implied promise.

This finding of the master cannot be reviewed here in the absence of the evidence on which it was based.

It is evident that this finding, taken in connection with the master's report, does not depend upon the construction of the reorganization agreement alone, inasmuch as the master refers to testimony of numerous witnesses on the subject, including the members of the reorganization committee (Rec. 860), the minutes of the committee (Rec. 864) and, in effect, finds that the provision in the plan concerning the payment of the floating debt related primarily to floating debts which had a legal or equitable lien or priority, although otherwise unsecured.

The master embodies, in his report, an abstract of the plan and a copy of certain portions of the agreement, but he refers to other oral and documentary evidence before him, which is not here.

The rule is elementary that the finding of the master cannot be reviewed without all of the evidence. For aught that appears from this record, the plan may have been modified before or after the deposit of securities by the Trust Company, or the Trust Company may have been told by every member of the committee that it had been or would be modified, or the finding of the master may have been based upon his other finding that the Trust Company was well acquainted with the purposes of the reorganization scheme, and that it had an intimate connection with and knowledge of the practical working out of the reorganization scheme. It may

well be that the master's finding was based upon the purpose of the floating debt provision to remove lien claims, and that the Trust Company knew of this purpose and acquiesced in it in depositing its securities.

VII.

Even if the reorganization plan and agreement amounted to an express contract to pay the floating debt (which is strenuously denied) yet it was not a contract made for the benefit of unsecured creditors, as its object, and hence the Trust Company cannot maintain an action upon it.

The reorganization plan and agreement were addressed to stockholders and bondholders, not to creditors. The obvious purpose of the agreement was "to protect the interests of the stockholders and bondholders of those companies which had become insolvent and which then or shortly afterwards would have to be administered by the court." (Rec. 854.) It was not the intention of the agreement to benefit creditors, although they might, and some of them did receive an incidental benefit therefrom.

In these circumstances, even if it be assumed for the purpose of the argument that the reorganization plan and agreement constituted a contract (which is strongly denied), yet the Trust Company is not entitled, in its capacity as creditor, to maintain any action thereon.

Our position in this respect was fully sustained by the master (Rec. 854-861), and his conclusions were sustained by the lower court, which has not been reversed by the court of appeals in this respect.

The master's finding, which, it must be remembered, was based not only upon the plan, but upon other oral and documentary evidence, is shown in the following quotations:

> It is claimed by the Trust Company that it appears from the reorganization plan and agreement that the floating debts of the constituent companies were to be paid, whether more or less than $475,000.00, the amount

named therein, which was simply in the nature of an estimation. The intervenor contends that no such liability was intended to be, or was in fact, created by the reorganization plan. The relations of the parties interested will be helpful in determining the meaning of that part of the agreement. The reorganization committee was merely an agency constituted by such bondholders and stockholders of the Gulf Company and its allied companies as saw fit to act in concert under the proposed reorganization plan and agreement, which were expressed to be for the benefit of the participating bondholders and stockholders. General or unsecured creditors of those companies were not parties thereto, the manifest purpose and object being to protect the interests of the stockholders and bondholders of those companies, which had become insolvent, and which then or shortly afterwards would have to be administered by the court. It became necessary for them to devise some plan for the disposition of the properties belonging to those companies which would preserve them for the benefit of stockholders and bondholders, which could only be done through concerted action on the part of the security holders, and hence the modified Philadelphia Plan of November 7, 1899, was adopted for that purpose. (Rec. 854.)

Neither the bondholders, stockholders nor the reorganization committee owed any legal or equitable duty to the Trust Company, unless such duty can be implied in some way from the reorganization plan and agreement. The Trust Company as a creditor was not intended to be, and was not in fact, a party to the reorganization agreements, though it received benefits therefrom in the exchange of its old securities for the new ones of the Southern Company; nor does the evidence in the record show that it ever changed or altered its position in any way on account of said floating debt provision. (Rec. 856.)

For the reasons above stated, the master is of the opinion that the Trust Company, in its capacity as creditor, is not directly interested in the floating debt provision of the reorganization plan, but that any right which it may have therein is collateral and incidental to the main purpose and object of such plan, and that the respondent had no such legal or equitable right as en-

titled it to avail itself of said floating debt provision. (Rec. 861.)

Other excerpts from the finding of the master upon this question will be found in our brief, pages 16, 17, 106 and 125.

Inasmuch as the reorganization plan and agreement were for the benefit *solely* of the security holders of the properties involved, it follows necessarily, upon authority from both the state and federal courts, that the Trust Company can claim no privity of contract; can maintain no action upon it, nor claim any right or benefit from it.

This Court, in *German Alliance Insurance Company* v. *Water Supply Company*, 226 U. S. 220, had under consideration the right of an insurance company, which had become subrogated to the right of a taxpayer who had suffered damage by reason of the breach of contract between the water company and a municipality, to recover against the water company the amount of damages which the insurance company had paid. It was held that there could be no recovery for the reason that the taxpayer was not a party to the contract and it did not appear that the contract was intended for his direct benefit. The Court said:

> Before a stranger can avail himself of the exceptional privilege of suing for a breach on an agreement to which he is not a party, he must, at least, show that it was intended for his direct benefit. For, as said by this Court, speaking of the right of bondholders to sue a third party who had made an agreement with the obligor to discharge the bonds, they "may have had an indirect interest in the performance of the undertakings * * * but that is a very different thing from the privity necessary to enable them to enforce the contract by suits in their own names." *Second Nat. Bank* v. *Grand Lodge F. & A. M.*, 98 U. S. 124, 25 L. Ed. 76; *Cf. Hendrick* v. *Lindsay*, 93 U. S. 149, 23 L. Ed. 857; *National Sav. Bank* v. *Ward*, 100 U. S. 202, 205, 25 L. Ed. 623, 625.

The Court approves the rule stated in *Second National Bank* v. *Grand Lodge*, 98 U. S. 124, to the effect:

that a third person cannot sue for the breach of a contract to which he is a stranger unless he is in privity with the parties and is therein given a direct interest.

It was conceded that the taxpayer had an interest in the faithful performance of the contract between the water company and the municipality, but it was held that this was an indirect interest and did not entitle him to maintain an action for breach of contract, the Court saying:

> He is interested in the faithful performance of contracts of service by policemen, firemen and mail contractors, as well as in holding to their warranties the vendors of fire engines. All of these employees, contractors or vendors are paid out of taxes. But for the breaches of their contracts the citizen cannot sue, though he suffer loss because the carrier delayed in hauling the mail, or the policeman failed to walk his beat, or the fireman delayed in responding to an alarm, or the engine proved defective, resulting in his building being destroyed by fire. 1 Beven Neg., 3 Ed. 305; Pollock, Torts, 8th Ed. 434, 547; *Davis* v. *Clinton Waterworks Co.*, 54 Iowa 61, 37 Am. Rep. 185, 6 N. W. 126.
>
> Each of these promisors of the city, like the water company here, would be liable for any tort done by him to their persons. But for acts of omission and breaches of contract, he would be responsible to the municipality alone. To hold to the contrary would unduly extend contract liability, would introduce new parties with new rights, and would subject those contracting with municipalities to suits by a multitude of persons for damages which were not, and in the nature of things could not have been, in contemplation of the parties.
>
> The result is that plaintiff cannot maintain this action, and though based upon the general principle that the parties to a contract are those who are entitled to its rights, is in accordance with the particular intent of those who made this agreement.

The Supreme Court of Missouri in a recent case (*St. Louis* v. *Contracting Co.*, 202 Mo. 451) had this question under consideration. The facts were as follows: The city of St. Louis entered into a contract with the Wright Con-

tracting Company whereby it undertook to grade and pave some of the streets and alleys according to certain plans and specifications, for the price therein stated; it gave a bond to properly and faithfully perform the contract according to all its terms. The contracting company refused to do any work whatever under the contract and the city relet the contract to one Perkinson at an advanced price of $6,500; Perkinson made the improvements according to the second contract and the city issued special tax bills against the adjoining property, each tax bill bearing its proportional part of the $6,500 increased cost of the improvements. Thereupon, the city of St. Louis, as trustee of an express trust, instituted suit against the Wright Contracting Company and its bondsmen to recover the damage sustained by the property owners by reason of being compelled to pay the increased cost of construction occasioned by the default of the contractor in the first contract.

The lower court held there could be a recovery, and this was reversed by the Supreme Court. The court says:

> There is a broad distinction between the principle involved where a contract is entered into between two parties for their *own use and benefit*, and where they make a similar contract for the *benefit of a third party*. A breach of the first would create no cause of action in favor of a third party, even though he was thereby deprived of large benefits which would have flown to him had the contract been performed; while in the latter case the breach would create a cause of action in his favor, even though the benefits he would have received from its performance might have been insignificant as compared to those he was deprived of by the breach of the former. * * * From what has thus been stated it can be seen that the character and value of the benefits and their loss or reception have no weight whatever in determining the question as to whether or not the contract was made for the benefit of third parties, who in this case are the property owners. * * * All of the well-considered cases start out by the assertion of the broad proposition that the contract must be made for the *benefit* of the third parties, as *its object*, and they must be the parties *intended* to be benefited thereby.

No one can for a moment assume that the object of making the reorganization agreement was to benefit the unsecured creditors or the owners of the floating debt; and yet it is necessary to indulge such a presumption before any right can be created under the plan and agreement in favor of the Trust Company.

The court continues:

> So it seems clear to us that whatever benefit may accrue to the property owners as a result of street improvements is purely an *incident* to the improvement, and not an *object intentionally sought* to be obtained by the contract which was made for the improvements. Third persons who are only *collaterally* and *incidentally* benefited by the terms of a contract have no cause of action for its breach.

The utmost that can be legitimately claimed by the Trust Company under the plan and agreement would be that the carrying out of the plan and the reservation of certain funds with which to pay off and discharge the floating debt, might incidentally benefit it if its claim came within the scope of the floating debt provision (which is denied). But such benefit would be only collateral and incidental and was not the purpose, object and intention of the plan. The court continues:

> The courts are not uniform in their opinions as to the principle upon which this class of actions are maintained. Many of them base their opinion upon the ground that the obligee in the contract owed the third party some debt or duty, either legal or equitable, and that by accepting the contract the law creates a privity of consideration between them upon which he could maintain a cause of action for its breach. *Vrooman* v. *Turner*, 69 N. Y. 280. But in applying that principle to this case, we are confronted with the proposition that the city owed no duty to the property owners to increase the value of their property, but were merely creating a fund, or providing a means, out of which or by which the contemplated improvements could be paid. To this proposition the respondent might reply that while that may be true, yet the law requires the city to let the contract at the lowest price obtainable, and that the property owners had the

> right to avail themselves of that price. In answer to that contention it may be said that, in all the cases where third parties have been permitted to recover upon a contract entered into for their benefit, said third parties had either adopted the contract or complied with the provisions thereof relating to them, or that the debt or duty which was owing to the third party had passed or vested in the obligee of the contract before the suit was instituted.

The reorganization plan and agreement were binding upon the Trust Company because it had assented to the legality and propriety of everything which it was contemplated would be done under the plan and agreement. No legal or equitable duty, therefore, was owing to the Trust Company. It cannot claim, under the theory of the Boyd case or otherwise, that any rights, property or equities were held by the committee which properly belonged to it. The principles of estoppel argued at length in the original brief are sufficient authority for this statement.

Upon the authority of this case, therefore, the conclusion is irresistible that the intention, purpose and object of the reorganization plan and agreement was to benefit the security holders. If there was any benefit to the Trust Company or other claimants it was purely incidental and collateral and therefore the Trust Company is not entitled to maintain any cause of action thereon.

A later case to the same effect is *Beattie Mfg. Co.* v. *Clark*, 208 Mo. 89.

The rule stated in *Howsman* v. *Water Co.*, 119 Mo. 304, is also in point. There a contract had been entered into between the town of Trenton and the Water Company, by the terms of which the Water Company agreed with said town to furnish, at all times, an adequate supply of water for fire and other purposes for public and private use, and further agreed that "should said Water Company, from lack of water supply, or other cause, except providential or unavoidable accident, fail to furnish a reasonable or adequate supply of water

to extinguish any fire, then it shall be liable for all damage occasioned by such fire or neglect."

The plaintiff's dwelling house was destroyed by fire and the action was against the Water Company for a breach of its obligation above quoted. The court held there could be no recovery for the reason that the contract was not made for the benefit of the plaintiff *as its object;* and the fact that he was *indirectly* or *incidentally* benefited by it did not give him the right to sue upon it. The opinion is an elaborate one, with the citation of many authorities.

Other cases of similar nature are:

Metropolitan Trust Co. v. *Topeka Water Co.*, 132 Fed. 702.

Allen Mfg. Co. v. *Shreveport Water Works Co.*, 37 So. 980.

The rule consistently adhered to by the federal courts is unfavorable to the Trust Company. The leading case is *Second National Bank* v. *Grand Lodge*, 98 U. S. 123. This was an action by the bank against the Grand Lodge of Missouri to compel the payment of certain coupons formerly attached to bonds issued by the Masonic Hall Association, a corporation existing under the laws of the State of Missouri, in relation to which bonds the Grand Lodge had adopted the following resolution:

> RESOLVED, That this Grand Lodge assume the payment of Two Hundred Thousand Dollars bonds issued by the Masonic Hall Association, provided that stock is issued to the Grand Lodge by said Association to the amount of said assumption of payment by this Grand Lodge as the said bonds are paid.

The court held that the bank, as the holder of the bonds, was not in such privity with the contract as to warrant a suit upon it, saying:

> It was a contract made for the benefit of the Association and of the Grand Lodge—made that the latter might acquire the ownership of stock of the former, and that the former might obtain a relief from its liabilities.

The holders of the bonds were not parties to it and there was no privity between them and the lodge. They may have had an *indirect* interest in the performance of the undertakings of the parties, as they would have in any agreement by which the lodge should undertake to lend money to the association or contract to buy its stock to enable it to pay its debts; but that is *a very different thing from the privity necessary to enable them to enforce the contract by suits in their own names.* We do not propose to enter at large upon a consideration of the inquiry how far privity of contract between a plaintiff and defendant is necessary to the maintenance of an action of *assumpsit.* The subject has been much debated and the decisions are not all reconcilable. No doubt the general rule is that such a privity must exist. But there are confessedly many exceptions to it. One of them, and by far the most frequent one, is the case where, under a contract between two persons, assets have come to the promisor's hands or under his control which in equity belong to a third person. In such a case it is held that the third person may sue in his own name. But then the suit is founded rather on the implied undertaking the law raises from the possession of the assets than on the express promise. Another exception is where the plaintiff is the beneficiary solely interested in the promise, as where one person contracts with another to pay money or deliver some valuable thing to a third. But where a debt already exists from one person to another, a promise by a third person to pay such debt being primarily for the benefit of the original debtor, and to relieve him from liability to pay it (there being no novation), he has a right of action against the promisor for his own indemnity; and if the original creditor can also sue, the promisor would be liable to two separate actions, and, therefore, the rule is that the original creditor cannot sue. His case is not an exception from the general rule that privity of contract is required. There are some other exceptions recognized, but they are unimportant now. The plaintiff's case is within none of them. Nor is he *sole beneficiary* of the contract between the association and the Grand Lodge. The contract was made, as we have said, for the benefit of the association, and if enforceable at all, is enforceable by it. That the several bondholders of the

association are not in a situation to sue upon it is apparent on its face.

The Trust Company is barred by the rule announced in the foregoing case. Nor does it come within any of the enumerated exceptions. It is estopped to claim that assets came into the hands of the reorganization committee or under its control, which in equity belonged to the Trust Company; nor can it be claimed that the Trust Company is the beneficiary solely interested in the provisions contained in the plan and agreement for the payment of the floating debt.

In *Keller* v. *Ashford*, 136 U. S. 610, the rule of the case above referred to is re-affirmed, and it is there held that a mortgagee has no right to enforce payment of the mortgage debt against the grantee of the mortgagor, by virtue of the assumption by the latter of the mortgage debt, and his agreement to pay the same. The court said:

> In equity, as in law, the contract of the purchaser to pay the mortgage, being made with the mortgagor and for his benefit only, creates no direct obligation of the purchaser to the mortgagee.

The mortgagee, however, is entitled to relief by bill in equity in which he may avail himself of the right of a mortgagor against his grantee, because in equity a creditor is entitled to avail himself of a security which his debtor holds from a third person for the payment of the debt.

In *Sayward* v. *Dexter*, 72 Fed. 758, the court applies the same rule, saying:

> But it is not every contract for the benefit of a third person that is enforceable by the beneficiary. It must appear that the contract was *made* and was *intended* for his benefit. The fact that he is *incidentally* named in the contract or that the contract, if carried out according to its terms, would inure to his benefit, is not sufficient to entitle him to demand its fulfillment. It must appear to have been the intention of the parties to secure to him personally the benefit of its provisions.

In *American Bank* v. *Railroad Company*, 76 Fed. 130, the syllabus is as follows:

> An agreement made by one person with another to pay a debt due by the latter to a third person is not the subject of suit by such third person, when there was *no intention to benefit him*, and nothing of value came under the contract within the control of the promisor which in equity belonged to such third person, or is subject to a lien in his favor.

The court said:

> The explicit language of the complaint makes it clear that the promise of the defendant was to pay an existing debt, and it was made for the benefit of the Chicago & Northern Pacific Railroad Company; and no facts are alleged from which an inference may be drawn that the parties to the contract were actuated by a desire to *benefit the plaintiff*, nor that the scope of their intentions included any provision for rights or interests other than their own; and there is no pretense that under the contract anything of value or assets have come to the promisor's hands, or under its control, which, in equity, belongs to the plaintiff, or is subject to any lien existing in favor of the plaintiff. The case, therefore, comes fully and fairly within the rule of the decision of the Supreme Court in the case of *National Bank* v. *Grand Lodge*, 98 U. S. 123. The rule and the authority of the case cited have received express recognition in the Circuit Court of Appeals for the Ninth Circuit, in the case of *Sayward* v. *Derter*, 72 Fed. 765.

The case of *Moyer* v. *Ft. Wayne Railroad Co.*, 132 Indiana 88, announces a rule fatal to the contention of the Trust Company. There the plaintiff agreed to erect a station for two railroad companies, each of which was to pay part of the cost thereof, and he agreed to pay part of the cost himself, although it did not appear that he was to have any interest in the station when completed. He built the station as agreed, but did not receive payment from one of the roads. Later this road was sold under a mortgage foreclosure, and bought in by the bondholders, who organized a new corporation to

own and run it. The new corporation used the station and plaintiff sued it for the amount which the former owners of the road agreed to pay him. It appeared that there was an agreement between the bondholders of the original company that a certain sum should be retained for the payment of small claims as required. The court held that the plaintiff could not recover and that the agreement created no obligation in favor of the plaintiff, saying:

> The provision in the contract between the bondholders, which we have quoted, does not bind the appellee to pay the appellant any sum whatever. It simply *authorizes* the directors to use that sum as they may deem necessary in the payment of claims. But, if it were conceded that the provision does create an obligation in favor of the appellant, still there is no right to recover upon it, *because it does not appear that the sum was not properly used to pay the claim specified, or other claims having rightful precedence of the appellant's claim.*

In this connection it should be borne in mind that the reorganization committee and the Southern Company, as shown by the evidence, have paid the floating debt of the constituent companies in an amount exceeding a million dollars. Even if the estimate of $475,000 for payment of floating debt had been a fixed appropriation of that sum for that purpose (which we deny), the liability of the committee and of the Southern Company would have been discharged when that sum had been paid out. (*Davis* v. *Dunn*, 121 Mo. App. 490; *Raithel* v. *Smith*, 68 Mo. 258.)

In *Freeman* v. *Pennsylvania Co.*, 173 Pa. St. 274, it is held:

> The holder of coupons representing interest upon railroad bonds has no right of action on an agreement by the lessee of the railroad to apply the net earnings to the payment of the interest coupons, and to buy up the coupons if the net earnings should not be sufficient to pay them; such holder of coupons being a stranger to the contract and the consideration.

In *McIlvaine* v. *Big Stony Lumber Company*, 54 S. E. 473, it is held:

> Code 1904, Section 2860, authorizes the assignee of a bond or a chose in action to sue in his own name and to maintain any action which the original obligee party or contracting party might have brought. *Held*, that such section did not authorize an original creditor to sue at law on covenants of third persons to assume and pay the debt where there was no consideration passing from such creditors to such covenantors, and there was no privity between them.

The court said:

> The test, therefore, in such a case, seems to be whether or not the promise or covenant sued on was made for the *sole benefit* of the plaintiff.

In *Armour & Company* v. *Construction Co.*, 78 Pac. 1106, it is held:

> One who furnishes provisions to a contractor doing work for a railroad cannot recover from one who gave a bond to the railroad to pay persons supplying provisions to the contractor, there being no privity.

See also *Rochester Dry Goods Co.* v. *Fahy*, 97 N. Y. S. 1013; *Nalle* v. *Costley*, (Tex.) 174 S. W. 625; *Chung Kee* v. *Davidson*, (Colo.) 15 Pac. 100; *Clark* v. *Construction Co.*, (Minn.) 142 N. W. 874; *O'Connell* v. *Trust Co.*, (Mo.) 147 S. W. 841; *Gulf Compress Co.* v. *Harris*, (Ala.) 48 Sou. 477.

It seems only necessary in conclusion to add that the Trust Company, in its capacity as creditor, was a stranger to the reorganization plan; the plan was not for its benefit, but for the benefit of the parties to it; and, therefore, within the rule heretofore stated the Trust Company has no right to avail itself of the provisions in the reorganization plan, with reference to the payment of the floating debt.

Nor can the Trust Company claim to come within any of the recognized exceptions to the rule. The reorganization committee acquired no property or assets upon which the Trust Company had any equitable lien. Indeed, no such claim is made either in the pleadings or by evidence.

VIII.

The Southern Company is not liable for the debts of the Belt Company upon the theory of a statutory consolidation of the two companies.

The Trust Company, in its brief (p. 87 *et seq.*) argues that the reorganization of the Gulf Company, Belt Company, and others, was a consolidation of all the companies involved in the reorganization, *including the Southern Company*, under and in accordance with the statute of the State of Missouri (Sec. 3077, R. S. 1909) which, in the event of a statutory consolidation, imposes upon the consolidated company all the debts and obligations of the constituent companies. The claim of the Trust Company, in this respect, was denied by the master (Rec. 824-854), and his conclusions were approved by the lower court, and they stand unreversed by the court of appeals.

No exception was taken by the Trust Company to the *correctness* of the master's conclusion on the consolidation issue, the only exception being that the master "should have omitted reference to or recommendation concerning the liability of the Southern Company for the floating indebtedness of the Gulf Company." (Rec. 893.)

We insist that the question of consolidation is not properly here for review for the reasons stated in our brief, pp. 167 *et seq.*

The specific charge in the answer of the Trust Company upon which the claim of liability by reason of the alleged consolidation is predicated (Rec. 310) is as follows:

> This respondent further shows that the organization of said Kansas City Southern Railway Company and exchange of its stocks and bonds above alleged for the stocks and bonds of said Belt Railroad Company, and the other steps taken in pursuance of said reorganization plan, *effected a consolidation of said Kansas City Southern Railway Company and said Kansas City Suburban Belt Railroad Company under the statutes of the State of Mis-*

> *souri;* or a consolidation *de facto*, and that said Kansas City Southern Railway Company is estopped to deny such consolidation, or to claim that the same was not legally complete; and that said Kansas City Southern Railway Company thereby became and is liable for all the debts incurred by said Belt Railroad Company to the same extent as said last mentioned company, including the debts of this respondent heretofore mentioned and alleged in this answer.

We have to deal, therefore, with the claim that the *Southern Company* and the *Belt Company* "became consolidated under the statutes of the State of Missouri." It is important to bear in mind that the *Southern Company* was one of the companies which, it is said, became consolidated, for the reason that the legal effect of the consolidation of railroad companies under the Missouri statutes is that the companies thus becoming consolidated *go out of existence* and give birth to a *new* consolidated company.

A brief review of the underlying facts which, the Trust Company claims, converted this *reorganization* of several railway companies, passing through a receivership at foreclosure sale, into a statutory consolidation of the reorganized companies including the *purchaser*, may assist in the consideration of the question.

The master reviews the facts in respect of which a statutory consolidation is predicated as follows (Rec. 825):

> It is not controverted that the Gulf road defaulted in the payment of its interest April 1st, 1899; that receivers were then appointed, and that thereupon a decree of foreclosure and sale was rendered February 5, 1900, and the property sold at such foreclosure sale on March 19, 1900, to the Southern Company, which became the purchaser thereof, and took possession on April 1, 1900, and has been operating the property since that time. The Belt Railroad Company was placed in the hands of receivers September 6, 1900, in a suit instituted by the Provident Company, the trustee named in the first mortgage on the Belt property. A decree of foreclosure and sale was rendered on November 6, 1901, and the foreclosure sale

had on December 31, 1901, the Southern Company becoming the purchaser thereof, and continuing to operate the property since that time. A Philadelphia committee, on August 17, 1899, promulgated a plan, which, on November 7, 1899, was modified, and under which the stockholders and bondholders of the Gulf Company and its allied companies, including the Belt, deposited their securities and in lieu thereof finally obtained new securities of the Southern Company. The Trust Company, being the owner of a large amount of these securities, including those of the Belt Company, deposited them with the reorganization committee, and obtained in lieu thereof certain stocks and bonds of the Southern Company, which the Trust Company still retains. The Trust Company was also one of the depositaries in the modified plan of reorganization, and it is claimed by intervenor and it is abundantly shown by the testimony in the record that the respondent actively co-operated in the reorganization of the Belt properties, and induced its correspondents to accept said plan and to exchange their securities for the Southern Company securities. The effect of the Trust Company's participation in the reorganization plan is hereinafter considered.

It is not controverted that the bondholders and stockholders of the Belt Company received the stocks and bonds of the Southern Company in the ratio provided by the reorganization plan, and that the Southern Company thereby became the owner in some capacity of practically all of the outstanding stocks and bonds issued by the Belt Company, and the former bondholders and stockholders of the latter company became the owners by exchange of the stocks and bonds of the Southern Company.

The Missouri statute providing for consolidation of railroad companies, under which it is alleged that the Southern Company and the Belt Company became consolidated (Sec. 3077, R. S. 1909), is set forth in the Trust Company's brief, page 87, and in the record, page 825.

It should be borne in mind that the Southern Company had express statutory power by Section 3080, R. S. 1909, to acquire and hold the stocks and bonds of the Belt Company. It "may acquire and may hold the obligations and stock of

other companies owning or operating any such lines of road." This section of the statute at the time of the reorganization was as follows (Sec. 1061, R. S. 1899):

> Any railroad company heretofore organized, or which may hereafter be organized under the laws of this state, may extend its line of railroad beyond this state into or through any other state or territory, and may acquire any line of railroad within or without this state which shall form a continuous line with the road operated by such company, by direct connection or over any other line or lines constructed or to be constructed, and which such company shall have the right, by contract or otherwise, when completed, to use or operate, and *may acquire and may hold the obligations and stock of other companies owning or operating any such lines of road;* provided, that no line of railroad shall be so purchased until a meeting of the stockholders of such company or companies of this state, party, or parties to such an agreement, whereby a railroad in this state may be purchased, shall have been called by the directors thereof, at such times and places and in such manner as they shall designate, sixty days' due notice thereof having been previously given, and the holders of a majority of such stock, by person or proxy, shall have assented thereto, or until a majority of the holders of the stock of such company shall have consented thereto, in writing, and a certificate thereof, signed by the president and secretary of said company or companies, shall have been filed in the office of the secretary of state.

The exchange of stocks and bonds whereby the stockholders and bondholders of the old companies received in lieu thereof the securities of the Southern Company, was, in effect, a purchase and sale (*Harriman* v. *Northern Securities Company*, 197 U. S. 244).

The foreclosure and sale of the Gulf Company, the Belt Company and the other companies involved, were duly and regularly had under the supervision of the court, and the titles to the properties were duly and regularly conveyed and confirmed by orders of court to the Southern Company. It was done pursuant to a reorganization plan and agreement, for the

obvious reason that transactions of that magnitude can be conducted only by organized co-operation of the interested parties. It was initiated, conducted, and carried on to a conclusion in the same manner and under substantially the same conditions as other railroad reorganizations have been conducted and carried on in this country for many years. It has never been claimed, so far as we are advised, that these reorganizations have amounted to a consolidation of all the participating companies, including the *purchasers* at foreclosure sale. It has always been supposed that they were *reorganizations* conducted through judicial proceedings, as distinguished from *consolidations.*

In the present instance, the existence of the mortgage indebtedness and the validity and priority of the mortgage lien are conceded. "It (the Trust Company) did not deny the validity or priority of the bonded debt," say counsel in their brief, p. 33. The properties embraced within the mortgages were subjected to the payment of the mortgage debts by judicial proceedings regularly initiated and carried on to final decree, and were sold at public sales. The considerations paid for the properties, "which were large and sufficient," says the master (Rec. 852), were paid into court and distributed under the directions of the court. The officer making the sale was directed by the court to convey the premises to the Southern Company, as the accepted purchaser, and deliver possession to it. The proceeds of the sale, which were paid into court, took the place of the mortgaged premises and were subjected to the same liens and charges as had attached to the property itself, and distribution was made in accordance with the equities and priorities of the respective claimants. Such a proceeding, we insist, is as far removed from a statutory consolidation as it is possible to conceive.

It is obvious, in the first place, that *no effort* was ever made, by any one, at any time, to take *any* of the steps provided for in the Missouri statute prescribing the proceedings necessary to effect a consolidation of railroad companies. There was not, at any time, any *intention* on the part of anyone to

invoke the provisions of the Missouri statute, or to form a consolidation under the terms of the statutes of that state. No one ever dreamed that a statutory consolidation was in contemplation, or that it had been accomplished.

Not only was there no *intention* to consolidate, but no steps were ever taken to comply with any of the necessary formalities required by the statute. It is not even claimed by the Trust Company that there was a *substantial compliance* with the terms of the statute.

Bearing in mind that the "essential provisions of the act" must be "complied with" (134 U. S., l. c. 698, and *Pingree* v. *Michigan Ry. Co.*, 118 Mich. 314) in order that there may be a consolidation, we proceed to consider what the requirements are.

In order that there may be a statutory consolidation, under Sec. 3077, R. S. 1909, it is necessary that,

(*a*) The *companies* interested shall enter into a *contract* fixing the terms and conditions of such consolidation.

(*b*) Such *contract* shall be ratified and approved by a majority in interest of all the stock held by each company proposing to consolidate either,

(*c*) At a *meeting* of the stockholders regularly called for the purpose, or,

(*d*) By the *approval in writing* of the persons or parties holding and representing a majority of such stock.

(*e*) A certified copy of such articles of agreement with the *corporate name* to be assumed by the new company shall be filed with the Secretary of State, when the consolidation shall be considered duly consummated, and a certified copy in the office of the Secretary of State shall be deemed conclusive evidence thereof.

(*f*) The *boards of directors* of the several companies shall then proceed to carry out said contract according to its provisions, calling in the certificates of stock then outstanding in the several companies or roads, and,

(*g*) Issuing certificates of stock in the *new consolidated company* under such corporate name as may have been adopted.

(*h*) Before any railroad companies shall consolidate their roads under said statute, they shall each file with the Secretary of State a *resolution* accepting the provisions thereof to be signed by their respective presidents and attested by their respective secretaries under the seal of their respective companies, which resolution shall have been passed by a majority vote of the stock of each at a *meeting* of the stockholders to be called for the purpose of considering the same, sixty days' public notice of the time, place and *purpose* of such meeting having been given by advertisement in some newspaper printed in the county where the general offices of said company or companies of this state are situated.

As the master states (Rec. 843):

> In the Burge case (100 Mo. App. 464) the court construes said Section 1059 (3077, R. S. 1909) as providing for the amalgamation of two or more railroad companies in this state, and the formation of one company. The statutory corporate formalities, requisite to effect such purposes, are plainly stated, and are such as to really appeal to one's intelligent judgment as being reasonably necessary to protect and safeguard both the corporate and individual interests involved in the consolidation of corporations, desiring to unite into one corporation.

Not one of the foregoing requisite steps to effect a consolidation was ever taken by the Belt Company, or by the Southern Company, or by anyone having any connection with them or either of them. The statute requires that the companies interested shall enter into a *contract*, which naturally presupposes a meeting of the board of directors and the adoption of a resolution authorizing the contract; in other words, *corporate action*. But not only was there no corporate action, no meeting of the board of directors of either company and no resolutions passed, but there was no *contract* made between the companies contemplating a consolidation, much less a

contract fixing the terms and conditions of such consolidation; nor was there any meeting of the stockholders to ratify any contract of consolidation; nor was there any approval in writing of such *contract of consolidation* by persons or parties holding and representing a majority of the stock; nor was there any certified copy of such contract or articles of agreement with the corporate name to be assumed by the new company filed with the Secretary of State; nor did the boards of directors of the several companies proceed to carry out such contract of consolidation; nor were there any resolutions filed with the Secretary of State accepting the provisions thereof, as required by the statutes.

But it is urged by counsel that the modified plan of reorganization and the reorganization agreement fulfilled the requirements of the statute above referred to. It is difficult to consider this contention seriously. The plan did not even *require* that the terminals at Port Arthur and Kansas City should be brought into the reorganization. They might be included and they might not. Arrangements for other terminals had already been made. All this is apparent from the following language of the plan (Rec. 815):

> *(f)* Or in the event that either or both of the said terminal properties are not so acquired, then (under arrangements *already provided)* the requisite terminal facilities at Kansas City and on the Gulf will be otherwise secured—in which event the amount of the new securities to be issued will, of course, be correspondingly reduced.

The reorganization committee were thus given a wide discretion, and had the power to modify the plan as they might deem advisable.

Whether the terminals at Kansas City or on the Gulf were to be included in the reorganization at all depended upon whether sufficient of their securities should be deposited "to warrant the retention of that property by the new company." If sufficient of the securities of the terminal properties should be deposited, then the plan provided that these properties, together with the Gulf property, should be operated

in the same interest. The new company would then own the stocks and bonds of the terminal companies and "thereby," in the language of the plan, "all three properties will be under one corporate ownership, management and control." It was also "*intended*, as soon as practicable, that the new company acquire the properties of the terminal companies in fee, and bring them directly under the lien of the mortgage." Whether the Belt Company was to be brought into the reorganization was a matter which only the future could decide. If it should be brought in, then the plan in a general way was naturally to have it tied to other properties in some way by consolidation, by stock control or otherwise. It is, we respectfully submit, the height of absurdity for counsel to assert that the plan assented to by the depositing stockholders for the purpose of securing a reorganization of the interested companies constituted the necessary and essential statutory steps to accomplish a reorganization of the properties.

Counsel assign various reasons in support of their claim that a consolidation was effected. They say, p. 95:

> Method was of no concern to them (the committee), but results were wanted. And they got results, and the very results intended by the statute, the unification of the three connecting lines of railroad into one company.

But this result was accomplished *without any consolidation*, when the committee, and afterwards the Southern Company, owned the securities of the Belt Company and the other companies involved, for it was expressly authorized by statute "to acquire and hold the obligations and stock of other companies owning or operating any such lines of road" (Sec. 1061, R. S. 1899, above quoted).

Again counsel say, p. 96:

> That what was done in this case was a virtual consolidation under the statute results from the fact that it could lawfully be done only under the conditions prescribed and for the purposes designed by the statute. The *only* authority for what was done is Section 1059 of the Missouri Statutes. One company cannot issue its stock for

> the entire capital stock of another company except as a means of consolidation under the conditions prescribed by the statute. It can absorb another company in that way, or in any other, only when the result will be a connected and continuous line of railroad. There was here no sale of the roads by the old companies to the new.

Counsel are mistaken in pointing to Sec. 1059 of the Missouri Statutes (Sec. 3077, R. S. 1909), as authority for the ownership by one company of the stock of another. Sec. 3080 R. S. 1909 (Sec. 1061, R. S. 1899), is express authority for the "results" set forth in the foregoing quotation. Under it, one company is permitted to "acquire and hold" the entire capital stock of other companies, thus bringing about the "unification of the three lines of railroad into one company," without accomplishing a consolidation under Sec. 3077. The two sections are separate and distinct, requiring different procedure and accomplishing different results.

The vital distinction between the two sections is pointed out in *Burge* v. *Ry. Co.*, 100 Mo App. 460, as follows:

> There are two methods recognized by the statutes of Missouri by which railroad corporations may become associated or merged. By Section 1059 of the Revised Statutes of 1899, provision is made for the amalgamation of two or more railroad companies in this State, and the formation of one company; Sec. 1061 contemplates the manner adopted by defendant in this case, and expressly legalizes the extension of the line of any railroad company organized under the laws of this State, by acquiring by purchase any line of railroad within or without this State, and the acquisition and ownership of the assets and property of the company so bought. Under the section of consolidation (1059) the absorbing corporation succeeds to all the powers, rights and property of the consolidated companies and becomes subject to all their obligations and liabilities. Under the section making valid the purchase by one railroad company of the line and property of another railroad company, no responsibility is imposed on the purchasing company for the obligations of its vendor. It is manifest that no statutory liability resulted from the mere purchase by defendant, and in the absence of

averment and proof that it acquired and succeeded to the line and property of the selling company otherwise than as a purchaser in good faith and for a valuable consideration, the transaction in nowise differs in legal effect from the purchase of any other property, realty or personalty, and no duty is devolved by law upon defendant to respond to the liabilities, whether in tort or in contract of the selling corporation. A mere purchase in good faith for value imposes no such obligation. *Powell* v. *North Missouri R. R. Co.*, 42 Mo. 63; *Hoard* v. *C. & O. R. R.*, 123 U. S. 222; *Fogg* v. *Blair*, 133 U. S. 534.

In Volume 3, Purdy's Beach on Private Corporations, p. 1844, it is said:

> The mere purchase by one corporation of the franchises and property of another at foreclosure sale or otherwise does not work a consolidation of the corporations, unless otherwise provided by statute.

In Volume 6, Am. & Eng. Ency. of L., 2d Ed., p. 801, it is said:

> Reorganization is to be distinguished from consolidation. The former term is used to designate the formation of an entirely new and distinct corporation for the purpose of purchasing the property of another corporation or superseding it in business without incurring any liability to the creditors of the latter.
>
> The purchase of the property and franchises of a railroad company at a foreclosure sale and the creation by the Legislature of a new company with rights, privileges, and franchises similar to those enjoyed by the former, and the transfer of the property to the latter, is not a consolidation.

Other cases of similar import are as follows:

St. Louis & San Francisco R. R. Co. v. *Cross*, 171 Fed. 480.
Gulf, Colorado & Santa Fe Ry. Co. v. *Newell*, 73 Tex. 334.
Chase v. *Michigan Telephone Co.*, 80 N. W. 718.
Hawkins v. *Central of Georgia Ry. Co.*, 46 S. E. 82.
Austin v. *Tecumseh National Bank*, 68 N. W. 628.
Meyer v. *Johnston*, 53 Ala. 237.

The master sums up the situation very accurately as follows (Rec. 843):

> In the case at bar, the proofs in the record do not show the necessary corporate action, or in fact, any action whatever, on the part of the Belt Company, providing for the terms and conditions of a consolidation with the Southern Company, or any other company; in fact, there was no corporate action whatever as to the alleged consolidation. Inasmuch as there was no contract between the two companies, it necessarily follows that there could not be any approval or ratification of it by a majority in interest of the shareholders, either at a stockholders' meeting, called for that purpose, or by the approval in writing of such contract by a majority of the stock interested.
>
> It is not pretended that the Belt Company, as a corporation, was a party to the reorganization plan and agreement, but simply that its stockholders became depositors thereunder. In other words, there were no regular corporate proceedings, as provided by the statute, but merely the individual stockholders' action, and, through which latter, it is claimed by the respondent there was a substantial compliance with the Missouri Statute.
>
> After a careful examination of all the authorities, cited by counsel, the master is not convinced that there has been a statutory consolidation, as charged in respondent's answer to the intervening petition.

For the same reasons it cannot be claimed that there was a *de facto* consolidation, which necessarily implies (a) an *attempt* to invoke the provisions of the statute permitting railway companies to consolidate; (b) a failure to comply with all of the requirements, and (c) the conduct of the company's business as a consolidated corporation (d) resulting in obligations or liabilities incurred in favor of those who have treated with the abortive consolidation as an actual one. The record does not present such a situation. The master, after concluding that there was no legal consolidation, correctly disposes of the claim of a *de facto* consolidation as follows (Rec. 844):

> If he is right in such conclusion, then how can there be a *de jure* consolidation in this case, which could only arise from a compliance with the Missouri statute? If

merely a *de facto* consolidation, or some kind of amalgamation of interests has been effected between the Belt and Southern Companies, then other questions, affecting the Trust Company's connection with the reorganization plan and agreement, may be determinative of respondent's claim against the intervenor for the Belt indebtedness; and these questions are hereinafter considered.

IX.

If the Southern Company and the Belt Company became consolidated under the Missouri statute, as claimed by the Trust Company, then both corporations ceased to exist. The Trust Company has recognized and continues to recognize the existence of both companies, and is estopped to assert that they were consolidated and thereby became extinct.

One of the conditions which necessarily attaches to a consolidation under the Missouri statute is that the constituent companies cease to exist as legal entities and a new corporation is *ipso facto* formed. If the Southern Company and the Belt Company became consolidated under the statute, then they both ceased to exist and some new corporation, *whose name has not been divulged*, immediately came into existence, holding all of the properties, and liable for all of the obligations of the constituent companies. This is apparent from the consistent decisions of this court as well as of the Missouri courts.

In *Pullman Company* v. *Missouri Pacific*, 115 U. S. 587, the court says (page 595):

> This (consolidation under the Missouri statute) clearly contemplates the *actual dissolution* of the old corporations and the *creation* of a new one to take their place.

The Supreme Court of Missouri, in the case of *State ex. rel.* v. *Lesueur*, 145 Mo. 322, 328, in speaking of the consolidation of railroads under the Missouri statute, says:

> We are of opinion that the consolidation, when completed in the manner provided, does create a *new corporation* just as effectually as any other mode allowed by our laws. The new corporation owns all the property, whereas the old companies only owned each its part. * * * By the consolidation the old companies are *dissolved* and a new corporation formed.

The court there held that upon the consolidation the new company thus formed was required, by virtue of Section 21 of Article 10 of the Constitution, to pay into the state treasury the fees provided for upon the *organization* of corporations.

In *Railroad Company* v. *Missouri*, 152 U. S. 301 (followed in *Yazoo & Miss. Ry. Co.* v. *Adams*, 180 U. S. 1), this Court, in speaking of the Missouri Statute, said:

> Looking at the act in question in this case, we find that by Section 1 any Missouri railroad company whose track should connect with the road of an adjoining state was authorized to make and enter into an agreement with such connecting company for the consolidation of the stock of the respective companies whose tracks should be so connected, making one company of the two, whose stock should be so consolidated upon such terms, conditions and stipulations as might be mutually agreed between them; that by Section 2 'Such consolidation shall not be made, unless the terms and provisions thereof shall be approved by a majority of the stock, or the holders of a majority of the capital stock in each of said companies whose stock shall be consolidated'; that by Section 3 the board of directors were authorized to adopt by resolution a new corporate name for the consolidated company, and call in the certificates of stock then outstanding in each company, and exchange them for stock in the new company; and providing that a copy of the consolidation agreement and the name adopted for the new company 'shall be filed with the Secretary of State, and shall be conclusive evidence of such consolidation, and of the corporate name of the consolidated company.' It is difficult to see how the Legislature could provide more clearly for the *extinguishment* of the prior companies and the formation of a *new* one than by providing that the two companies shall become one, that new certificates of stock

shall be issued in exchange for the stock of the constituent companies, and that the consolidation agreement shall be recorded with the Secretary of State as the charter of the new company. In our opinion this was the effect of the act in question.

The rule is the same in other jurisdictions.

In *Adams* v. *Railroad Company*, 24 So. 211, it is said:

> It is in the interest of clearness of definition that consolidation should be limited to signify such union of two or more corporations as necessarily results in the *creation* of a third *new* corporation, and, as we understand the decisions, this is what is known as the American doctrine, and the better view.

In *Vicksburg Telephone Co.* v. *Telephone Company*, 30 So. 725, the court says (728):

> There seems to be a great confusion as to the differences between consolidation and merger and sale. Rightly understood there never can be a consolidation of corporations except where all the constituent companies cease to exist as separate corporations, and a new corporation, to-wit, the consolidated corporation, comes into being. A merger, rightly understood, is not the equivalent of consolidation at all, but exists where one of the constituent companies remains in being, absorbing or merging in itself all the other constituent companies.

In *Lee* v. *Atlantic Coast Line Railroad Co.*, 150 Fed. 775, it is held:

> There is a distinct difference between a consolidation and a merger of two railroad companies. In a consolidation, both go out of existence as separate corporations, and a new corporation is created, which takes their place and property; while in case of a merger one loses its identity by absorption in the other, which remains in existence, and succeeds to its property, and issues its own stock to the stockholders of the merged company.

It necessarily follows, therefore, that if there was a statutory consolidation, both the Belt Company and the Southern Company have gone *out of existence*, and a new consolidated

company has been formed. Counsel have not taken the pains to inform us as to the name of the new consolidated company which, if their position is correct, has thus come into existence and succeeded to the properties as well as the obligations of the constituent companies. This new company cannot be the Southern Company, because the charge is that the *Southern Company consolidated with the Belt Company,* which necessarily implies the extinction of both.

The acts and conduct of the Trust Company are strangely at variance with its legal theories. It has recognized and still recognizes both of these companies as existent, as proper parties defendant, as able to respond to judgments against them, and is now in this Court engaged in an effort to support the decree of the court of appeals against the Southern Company.

On November 20, 1901, which was after the foreclosure decree in the Belt case, the Trust Company stipulated that the *Belt Company* should come into the case as a co-plaintiff with its receivers (Rec. 888-889), so that judgment might be rendered against it without a cross-bill. On December 9, 1901, the Trust Company answered the bill of the Belt Company and its receivers, the answer being filed out of time by stipulation (Rec. 114-115). On June 5, 1905, the Trust Company again answered the Belt Company's pleading by stipulation (Rec. 266, 312), and again, on July 6, 1906, the Trust Company answered the bill of the Belt Company and its receivers (Rec. 461), filing the same by stipulation. (Rec. 467.) On June 25, 1910, the Trust Company recovered the final judgment against the Belt Company which is the basis of this proceeding.

In February, 1905, years after the alleged consolidation, the Trust Company stipulated that the Southern Company should come into the case (Rec. 164-166), and on March 5, 1905 (Rec. 186), it answered its intervening petition which set up the claim involved in this appeal. On May 20, 1905, the Trust Company answered the amended intervening petition of the Southern Company (Rec. 293), the amendment being made by stipulation (Rec. 267).

On March 15, 1905, the Trust Company brought suit in the circuit court of Jackson County, Missouri, against the Southern Company on thirty-three counts, being, in substance, the claim herein involved of the liability of the Southern Company for the debts of the Belt Company *and a similar claim for the debts of the Dock Company.* (Rec. 493-523.)

On the same date the Trust Company filed another suit in the circuit court of Jackson County, Missouri, against the Southern Company (Rec. 499, 528), setting up the alleged liability of the Southern Company for another debt of the Belt Company.

On July 2, 1906, the Trust Company brought suit against the Southern Company in the circuit court of Jackson County, Missouri, to recover by reason of the alleged indebtedness of the *Gulf Company* to the Trust Company, based upon substantially the same allegations. (Rec. 499, 535.) The three state court suits are still pending.

The Trust Company admits, by its pleadings, that the Belt Company is sufficiently alive to have a receiver, to have judgment rendered against it in this case pursuant to the stipulation above referred to, to have a deficiency judgment rendered against it in the foreclosure suit, to have its mortgage foreclosed in the foreclosure suit to which the Trust Company was a party, and to have its property conveyed by commissioner's deed to the Southern Company.

The Trust Company, by its pleadings and stipulations, admits that the Southern Company is sufficiently alive and in existence to respond to any claim which the Trust Company may be able to establish in this case, and is competent to issue its stocks and bonds, which the Trust Company received under the plan and now holds. It admits that so far from being extinct, the Southern Company was a proper party defendant to three suits filed in 1905 and 1906 in the state court, and also a proper party defendant to the Trust Company's answer to the Southern Company's intervening petition filed in 1905, which the court of appeals treated as a cross-bill.

The Trust Company would be more consistent if it would

be content with the claim, either (a) that the Southern Company has become consolidated and gone out of existence, in which event this suit must fail, or (b) that the Southern Company has remained in existence sufficiently to have the decree of the court of appeals against it affirmed by this Court, in which event there was no consolidation. It is not in a position to assert both of these conflicting claims successfully.

X.

The acquisition by the Southern Company of the stocks and bonds of the Belt Company and other companies under the reorganization plan and agreement did not operate as a consolidation of those companies.

The fact upon which the Trust Company mainly relies to support its charges of consolidation is the ownership by the Southern Company of the stocks and bonds of the Belt Company. If this constitutes a consolidation *de jure* or *de facto*, in whole or in part, it will be startling as well as important news to the railway interests of the country. It is a matter of common knowledge that there is hardly a railway system in the country in which the parent company does not own the stocks or bonds, or both, of the subsidiary companies; and no one hitherto has ever thought that this fact effected a statutory consolidation of the different companies.

It is true that as a result of the modified plan of reorganization, the reorganization committee became the holder, and afterwards the Southern Company became the owner, of a great majority of the stocks and bonds of the Belt Company. There was nothing unlawful in this. On the contrary, such ownership was expressly authorized and permitted by Section 3080, R. S. 1909, quoted *supra*, and it did not effect a consolidation.

In *Pullman Palace Car Co.* v. *Missouri Pacific Railway Co.*, 115 U. S. 587, it appears that the Missouri Pacific Railroad Company acquired and owned the capital stock of the St.

Louis, Iron Mountain & Southern, and the question arose as to whether the Missouri Pacific road controlled the Iron Mountain by ownership, lease or otherwise, and *the Missouri statute concerning consolidation of corporations was drawn in question.* The court held that both companies, notwithstanding such stock ownership, continued to be separate, independent companies, and that the obligations of one company were not enforceable against the other. If the position now taken by the Trust Company is correct, this Court should have decided that there was a consolidation of the Missouri Pacific and the Iron Mountain by virtue of ownership of stock, and the decision of the case would necessarily have been different.

In *Peterson* v. *Chicago, Rock Island & Pacific Railway Co.*, 205 U. S. 364, it appeared that the Chicago, Rock Island & Pacific Railway Company owned a controlling interest in the stock of the Chicago, Rock Island & Gulf Railroad Company, a corporation of the State of Texas. Service of summons was had upon an agent of the latter in an action against the former upon the theory that there was an identity of interests, or an agency, sufficient to warrant the proceeding. The court held that the attempted service was not sufficient to give jurisdiction, saying:

> This record discloses that the officers and agents of the Gulf Company control its management. The fact that the Pacific Company owns the controlling amount of the stock of the Gulf Company and has thus the power to change the management does not give it present control of the corporate property and business.
>
> The conduct and control of the business in Texas was intrusted to the Gulf Company. As the largest stockholder the Pacific Company had an interest in that business, but a separate corporation had been legally created in Texas, with authority to make contracts and control its own affairs and carry on its own business. This separate corporation had its own officers, a large amount of its own property, was responsible for its contracts and to persons with whom it dealt.

In *Atchison, Topeka & Santa Fe Railroad Co.* v. *Cochran*,

43 Kan. 225, it appeared that that company owned the capital stock of the Southern Kansas Railway Company. An action was brought against the Santa Fe to recover for personal injuries occasioned by the employees of the Southern Kansas. It was held that the fact that the Santa Fe owned the capital stock of the Southern Kansas did not render it liable in the action, the court holding where the rights and powers of a railroad in relation to a connecting road are those of a stockholder merely, the former, as such stockholder, is not liable for the negligence of the latter.

To the same effect see:

Commonwealth v. *Bridge Company,* 64 Atl. 909, 911.
Ulmer v. *Lime Rock Railroad Co.,* 57 Atl. 1001, 1006.
Exchange Bank v. *Construction Company,* 25 S. E. 326.
Jessup v. *Illinois Central,* 36 Fed. 735, 741.

There is no escape from the conclusion that the Southern Company had the lawful right to own and hold the stocks and bonds of the Belt Company, and that such ownership did not constitute a consolidation of the two companies. They both continued to exist, each one controlling its own property through its own officers until September 6, 1900, at which time receivers were appointed for the Belt Company. The receivers continued to operate the property until January 1, 1902, at which time the Southern Company, *as the purchaser at foreclosure sale* of the Belt property, received the commissioner's deed, entered into possession of the property, and has continued the operation ever since.

The master's conclusions on this branch of the case, which we believe correctly state the situation, are as follows:

> It would seem, then, that the Southern Company had the lawful right to own and hold the stocks and bonds of the Belt Company, and that such ownership of itself did not have the effect of constituting a consolidation of the two companies, as both corporations continued to exist, and each controlling its own property, through its own officers, until September 6, 1900, when the receivers were appointed for the Belt Company, and which receivers

continued to operate the property until January 1, 1902, at which time the Southern Company, as the purchaser at the foreclosure sale, received the commissioner's deed and entered into possession of the property and has continued its operation. (Rec. 842.)

XI.

The foreclosure of the mortgage upon the property of the Belt Company, the sale thereunder, and the purchase by the Southern Company, did not operate to establish a consolidation.

The Southern Company having become the lawful owner of a large majority of the securities of the Belt Company, as it was authorized to do by the statute of Missouri, and a default having occurred in the payment of the mortgage debt, a bill of foreclosure was filed by the trustee in the mortgage, a decree of foreclosure and sale rendered, the mortgaged property was exposed to public sale, and the Southern Company became the purchaser.

The bonds and other obligations deposited under the agreement and plan "shall not be deemed satisfied, released, or discharged by any delivery of new securities, but shall remain in full force and effect for all purposes." (Rec. 823.) The bonds of the Belt Company, therefore, were not "in practical effect, extinguished," as claimed by counsel in their brief, page 35.

There was nothing in this proceeding which directly, indirectly, or even remotely, came within the purview of Section 1077, R. S. 1909, providing for the consolidation of railroad companies. As above stated, the property of the Belt Company was taken by judicial process in a proceeding to which the Trust Company was a party and sold at public sale, and the proceeds were by the court distributed in accordance with established legal principles. The fact that, by stipulation, the foreclosure decree was without prejudice to the rights of the Trust Company does not alter the situation or convert an orderly judicial sale into a statutory consolidation.

There is little to be added to what the master has well said upon this branch of the case:

> It is not disputed that the respondent Trust Company was a party to the foreclosure proceedings, and that the decree of foreclosure was and is in full force and effect and is conclusive as against the respondent in respect to the existence of the mortgage, the indebtedness secured thereby, and its non-payment. *No issue has been made by the pleadings or otherwise as to the regularity or validity of the foreclosure sale, at which the intervenor acquired the mortgage properties and assets of the Belt and allied companies, forming the Belt system.* In the legal enforcement of the mortgage lien, securing the bondholders, the properties of these companies, respectively, were subjected to the payment of their bonded indebtedness, were sold at public vendue to the highest bidder, and the purchase price was paid therefor, as provided in and by the foreclosure decree made in this court, and, thereupon, the title to said properties was conveyed to the purchasers at such foreclosure sales. The proceeds of the sales were, as required by the decrees, paid into court, and there constituted a trust fund, in lieu of the property sold, and subject to distribution by the court, pursuant to the mortgage liens. (Rec. 845.)
>
> The master has endeavored to make a critical examination of all the authorities submitted by counsel on the consolidation issue, distinguishing, as best he could, the conclusions of the court in each case by reference to the particular points involved therein, so as to reach a proper conclusion as to the legal significance of the specific transaction entered into by the Southern and Belt Companies, pursuant to the reorganization plan and agreement, including the foreclosure sales of the properties comprising the Belt system. In his opinion, there was no consolidation effected by what was done by the corporations involved, but that the transaction, when considered in its entirety, was in fact a reorganization scheme, intended to bring about a certain union or combination of properties, by which combination additional strength would be given them as a whole, as they were all dependent upon each other for the present as well as future railroad advantages and benefits; but such combination or union of these properties was to be consummated only after their pur-

chase at the foreclosure sales under the mortgage liens thereon, thereby intending to first acquire the titles, pursuant to the contract liens on the properties, and then utilize the properties so purchased by uniting and combining them in one corporation, which would be able to realize better results from the joint operation of the roads concerned than had been done in their separate operations. (Rec. 849-850.)

The following cases are in point:

National Foundry Works v. *Oconto Water Co.*, 105 Wis. 48.
Hoard v. *Chesapeake & Ohio R. R. Co.*, 123 U. S. 222.
Dickey v. *R. R. Co.*, 122 Mo. 223.
Holton v. *R. R. Co.*, 25 Mo. App. 322.

XII.

The authorities relied upon by the Trust Company in aid of its claim of consolidation do not support its contention.

It should be constantly borne in mind that the charge made by the Trust Company is that a *statutory consolidation* was effected between the Southern Company and the Belt Company. With this charge in view, we proceed to consider the authorities relied upon in support of this contention.

The term "consolidation" is sometimes loosely used to describe *any* union of corporate interests or rights. As thus used, it is a word of indefinite meaning and is frequently employed vaguely to comprehend practically any relationship of corporations to each other.

In *Northern Securities Company* v. *U. S.*, 193 U. S. 197, the surrender to the Northern Securities Company of the capital stock of the Great Northern and the Northern Pacific Railway companies, and the issue in lieu thereof of capital stock of the Securities Company, is called a "consolidation" within the meaning of the anti-trust act.

In *Pearsall* v. *Railroad Co.*, 161 U. S. 646, it is held that to vest designedly in one person, or set of persons, a majority of

the stock of two competing lines of interstate railroad, is a "consolidation" within the meaning of the statute prohibiting the consolidation of the whole or any portion of the capital stock of a railroad corporation, with the capital stock or any portion thereof, of any other road having the same general direction or location.

In *East St. Louis Connecting Railway Company* v. *Jarvis*, 92 Fed. 735, it is held that a lease of a parallel and competing railroad for ten years is a "consolidation" within the meaning of the Illinois Constitution prohibiting the consolidation of parallel or competing lines. The court holds that:

> The term "consolidation," we think, must be construed to have been used in the sense of "join" or "unite."

No one would for a moment suppose that the "consolidation," referred to in the foregoing cases, was a statutory consolidation *such as renders the consolidated company liable for the debts* of the participating companies. These cases serve to illustrate the varying meaning of the word "consolidation," depending wholly upon the connection in which it is used.

We are only concerned, however, with a statutory consolidation which imposes upon the company resulting from the consolidation the liability for the debts of the constituent companies. It is confidently asserted that none of the cases cited by the Trust Company are applicable to the case under consideration.

They belong to the class of so-called "consolidations" where the property and assets of one corporation are taken over by another, *without judicial proceedings and without the payment of a consideration which may inure to the benefit of the creditors*, the effect of which is to impose upon the company receiving such property or assets, the liabilities of the conveying company to the extent, at least, of their value. The reason upon which this rule is based is most obvious. A corporation possesses certain property and assets, which are the basis of its credit, and to which the creditors look, and have a right to look, for the payment of their claims. Any arrange-

ment, whether by conveyance or merger or so-called "consolidation," or other legerdemain or vermiculation, whereby the property and assets of the company are removed apparently from the reach of creditors is a fraud upon them which equity will not tolerate, and hence a company which, without the payment of a consideration, receives and appropriates to its own use such property and assets is held to assume the liabilities of the company from which it receives them. This is loosely termed a "consolidation," but it is very far from a statutory consolidation, such as is charged in this case.

In *Shadford* v. *Detroit & Ann Arbor Railway*, 130 Mich. 300, the syllabus is as follows:

> The consolidation of a street railway company for the sole purpose of absorbing all the business and property of other street railway companies, brought about by the issue of stocks and bonds in the new company to the stockholders and bondholders of the old companies to replace their stock and bonds, which are surrendered and cancelled, and *without the payment of any consideration to the old companies for the transfer of their property*, constitutes a consolidation, and not a sale, and makes the new company liable for the debts of the old companies.

The court said:

> The Electric Company (the purchaser of the assets of the old company) paid *not a dollar* to the other companies as compensation for the transfers of all their properties to it.

Counsel for the Trust Company relies upon the case of *Chicago Ry. Co.* v. *Ashling*, 43 N. E. 373, where the St. Louis company conveyed all of its physical property and franchises to the Santa Fe company, *without consideration*, and without making any provision whatever for the payment of its debts. Mary L. Ashling recovered a judgment against the St. Louis company for the negligent killing of her husband and in a suit against the Santa Fe company it was held that the said conveyance amounted to a consolidation under the Illinois statutes. It is to be observed that the Illinois statute does not provide the method or manner in which consolidations are to

be effected and does not prescribe the steps to be taken. There is no definition of what constitutes a statutory consolidation. Furthermore, the Santa Fe company did not acquire the property of the St. Louis company as the result of a foreclosure sale, at which the purchase price was paid in court for the benefit of those entitled to it. It did not acquire the property as the result of a *bona fide* sale for the full value of the property, in which the consideration passed to the St. Louis company and stood in lieu of its property and so became subject to the claims of the creditors. It is perfectly apparent that the Ashling case would not have been regarded as a consolidation under the Missouri statute, in which the constituent companies go out of existence and a new company is created.

In *Barrie* v. *Ry. Co.*, 138 Mo. App. 557, there was presented the question of the liability of the lessor for the debts of the lessee where the property was re-transferred by the lessee to the lessor "without adequate consideration and where the evident purpose of such transaction was to avoid the liabilities of the lessee." It was held that the transferee under such circumstances became liable for the debts. The court is careful to say (l. c. 651) that it does not place its decision upon the ground that there was a consolidation.

In *Black* v. *Ry. Co.*, 110 Mo. App. 198, the case presented was that of a 99-year lease of railroad property. In a suit for damages brought upon the theory that the two companies had consolidated, the court instructed the jury to find for the defendant on the ground that no merger or consolidation of the two companies had been shown, and this was affirmed upon appeal. It is *not* held that the lease was a statutory consolidation.

Also *Many* v. *Surety Co.*, 103 Mo. App. 716, in which it appeared that the National Surety Company of New York had absorbed all the assets and assumed all the liabilities of the Surety Company of Missouri and was in all respects its corporate successor. It was not held that this was a statutory consolidation, but liability was placed upon other grounds.

In none of the cases cited by the Trust Company was there the important element of a foreclosure sale in which the mort-

gaged property was sold and the proceeds thereof distributed under the supervision of the court. They are all cases where the property was all swallowed up in the transaction and thus placed beyond the reach of creditors. The fact that the court of appeals in the Barrie case, and the Supreme Court in *Johnson* v. *United Rys.*, 247 Mo. 326, did not briefly dispose of the cases by saying that the transactions under consideration amounted to statutory consolidations is persuasive, if not conclusive, evidence of the correctness of our contention.

The Trust Company by virtue of the stipulation providing that the decree was without prejudice to it is in no better position than it would have been had it not been a party to the proceedings, and in that event it would not have been permitted to contend that the mortgage foreclosures and purchases were statutory consolidations. They were not so for the reasons: (a) they were not *intended* to be statutory consolidations, (b) there was neither a *full* nor *substantial* compliance with the requirements of the statute, and (c) they were reorganizations conducted under judicial sanction by which the reorganized properties passed to the purchasing company at foreclosure sales, and this effectively and conclusively *excludes* the conception of a statutory consolidation.

XIII.

The Trust Company is precluded by its laches from asserting its claim against the Southern Company.

The finding of the master (Rec. 871, 872) is that the Trust Company was barred by its laches from asserting its claim against the Southern Company. There was no exception in the lower court to the master's conclusion in this respect, or to his findings of fact upon which the conclusion is based.

The Trust Company's intimate connection with the reorganized companies, its familiarity with the plan of reorganization, and its accurate knowledge of all the proceedings

connected therewith, have been pointed out heretofore and need not be repeated.

The first assertion by the Trust Company of any claim against the Southern Company, based upon a charge of consolidation or of express contract, was made in March, 1905, more than five years after the plan of reorganization had been formulated and declared effective, five years after the organization of the Southern Company, and nearly four years after the Belt property had been conveyed to the Southern Company.

If the Southern Company were liable upon the theory of a statutory consolidation, or upon the theory that the reorganization plan and agreement amounted to an express contract for the benefit of the Trust Company, then the latter could have brought its *action at law* directly against the Southern Company at any time during the intervening period of more than five years after the plan had been declared effective. There was no necessity of waiting until judgment was first obtained against the Belt Company.

The intervening years, as the master found, were a period of great activity on the part of the Southern Company; its securities were listed on stock exchanges and sold and resold in the markets of this country, as well as in Europe; and its railroad properties were improved by the expenditure of large sums of money—all in ignorance of the Trust Company's concealed claims. Every consideration demanded that the Trust Company should act promptly and assert its claims, if it thought it had any. Doubtless the explanation of the Trust Company's inaction lies in the fact that its theories of consolidation and express contract were merely afterthoughts brought forward by counsel more than five years after this litigation was initiated, in an effort to bolster up the case.

We submit that this great and unexplained delay in the assertion of the Trust Company's claims against the Southern Company amounts to inexcusable laches.

The master's findings of fact and conclusions of law briefly and concisely dispose of the issue of laches adversely

to the Trust Company in the following language (Rec. 871, 872):

> In respect to the contention of intervener that the respondent is barred by laches from asserting its Belt indebtedness claim against intervener, it is well to reiterate that the reorganization agreement was promulgated November 7th, 1899, that the Southern Company took possession on January 1, 1902, of the properties formerly belonging to the Belt system, and, also, that the Trust Company failed to assert its claim against the Southern until it was done in this cause in 1905. The Southern securities, which were issued and exchanged for those of the Belt, were promptly listed on the New York Stock Exchange, as well as elsewhere, and, since then, have been sold and resold in this country and Europe, during the period intervening between the incorporation of the Southern in 1900 and the assertion, in 1905, of respondent's claim against it, as the respondents well knew. In the meantime, the Southern Company was engaged in working out the details of the reorganization plan, and developing its combined railway system, thereby appreciating the value of the very Southern bonds and stock acquired by the Trust Company under said plan. It is evident that, if the intervener should have been held liable for all the unsecured indebtedness of the constituent companies of the old Belt System, including the large amount claimed by respondent, the effect of such liability would necessarily have been to depreciate the value of all the Southern securities, and, to that extent, operate to the injury of the security holders.
>
> In view of the intimate connection and knowledge of respondent, as heretofore shown, with the practical working out of the reorganization scheme, and the large financial interests it had in the successful carrying out thereof, it is manifest that its conduct in the premises should not be of such nature as to be prejudicial to the rights of others interested in the Southern, and its securities, that is, should not be such as to influence or cause them to do things which they would not otherwise have done, provided the Trust Company, at the outset, had promptly asserted the claim in controversy, before the position of others interested had been materially influenced and changed by its conduct in the premises.

In reaching this conclusion, the Master is not unmindful of the controversy between the Trust Company and certain members of the Reorganization Committee in respect to the latter paying, or causing to be paid, the Belt debt to the respondent, all of which preceded the Belt foreclosure. In his judgment, the fact of such controversy accentuated the importance of active measures by the Trust Company against the Southern, and affords no reason whatever for the respondent's long delay in asserting its claim in this cause. In support of intervener's contention, the following authorities have been cited, and, in the main, they are influential in that direction:

New York, etc., Co. v. *Louisville, etc., R. Co.*, 97 Fed. 226.
Harriman v. *Northern Securities Co.*, 197 U. S. 244.
Carey v. *Houston, etc., Ry. Co.*, 52 Fed. 671.
Wenger et al. v. *Chicago, etc., R. Co.*, 105 Fed. 796.
Anthony v. *Campbell*, 112 Fed. 505.
Spencer v. *Seaboard Air Line*, 137 N. C. 107.

In *Wenger* v. *Chicago & E. R. Co.*, 105 Fed. 796, it was stated, in effect, that the holder of an unliquidated claim for damages against a railroad company was held barred, by laches, from the right to charge a liability upon a reorganized company, succeeding to the property, on the ground that it had issued the stocks and bonds to the stockholders of the old company, and the transaction had been completed, before the claim holder asserted his claim against the new company, though he had ample opportunity to do so.

In *Anthony* v. *Campbell*, 112 Fed. 212, Judge Thayer, delivering the opinion, said:

"A man cannot remain silent for three or four years, knowing that one corporation, of which he is a creditor, has wrongfully transferred its property to another, and that third parties are dealing with the new corporation, and trusting it on the supposition that the transfer was lawful, and then be heard to assert in a court of equity that because of the alleged unlawful transaction he has an equitable lien on all the corporate assets, which is superior to other creditors. Such conduct evinces an intention or a desire to profit by the mistakes of innocent third parties and ought not to be encouraged. * * *

In the present instance the testimony shows that the intervener took no action until nearly four years after he was advised of the transaction—a period of silence and inactivity which must be deemed more than sufficient to bar his right to equitable relief on the ground that he has a general lien."

In the opinion of the Master, the surroundings, conduct and laches of the Trust Company in this matter have been such as to preclude it, (a) from claiming that the reorganization scheme was fraudulent as against it, and, also, (b) from asserting its claim in controversy against the Southern Company.

XIV.

A review of the authorities relied upon by the Trust Company in support of its claim to the Central Improvement property.

The Trust Company relies upon *Humphreys* v. *McKissick*, 140 U. S. 304. There the question was whether certain elevator property passed under the after-acquired property clause of the St. Louis, Kansas City & Northern Railway Company. The Elevator Company was organized by certain officers of *five* railway companies. These companies each subscribed for an equal amount of the stock in the Elevator Company and the elevator was erected at a cost of $280,000. When completed, the elevator was leased to certain parties, who afterwards operated it as tenants of the Elevator Company. The elevator building was situated more than half a mile distant from the railroad of the mortgagor company and was erected on land *not belonging to the Company*, but leased from the Union Pacific Railway Company. The lower court directed the receivers of the mortgagor to deliver a proper assignment of the mortgagor and of themselves as receivers—it being stipulated that the mortgagor had no interest otherwise than as *stockholder* in the property of the Elevator Company.

The court held that the *stock* in the Elevator Company could not be an appurtenance to a road. The court adds:

> Had the elevator been constructed upon *property covered by the mortgage*, it might have been contended that it fell, to the extent of the one-sixth interest, under the mortgage, as one of the depots of the company. The term 'depot' in the mortgage is not necessarily limited to a place provided for the convenience of passengers while waiting for the arrival or departure of trains. It applies also to buildings used for the receipt and storage of freight, which, when received, is to be safely kept until forwarded by the cars of the company or delivered to the owner or consignee. Such a building, whether existing at the time of the mortgage, or constructed afterwards upon the *property of the company* covered by it, may pass under the mortgage as one of its depots, but will not pass as an appurtenance to the property previously existing.

It is obvious that the rule stated in the foregoing case is not in any way controlling in the present case. Here we are not concerned with a building erected upon leased ground at some distance from the railroad, to reach which the intervening tracks of some other company must be crossed. We are concerned here with *real estate itself* purchased with the funds of the Belt Company and Air Line for their corporate purposes respectively, to be used for right of way and terminals—the naked title being placed in the Central Company purely as a matter of convenience and under the erroneous supposition that by so doing the property would be free from the lien of the mortgages. Two results followed. First, an implied or resulting trust was created in favor of the company paying the money to acquire each piece of property, so that the Central Company held the legal title as trustee. Secondly, the properties fell within the description of the subsequently acquired property clause of the mortgages and the lien thereof immediately attached. In short, the companies furnishing the money became the beneficial owners of every interest in the property so purchased, and such ownership became impressed with the liens of the mortgages and afterwards passed to the

purchaser at foreclosure sale. We are not here dealing with appurtenances. The case falls within the rule clearly stated in *Guaranty Trust Co.* v. *Atlantic Coast Electric Co.*, 138 Fed. 517, and other cases heretofore cited.

The other cases cited by the Trust Company are not in conflict with this position. *Pardee* v. *Aldridge*, 189 U. S. 429, holds that "it was a *question of fact* whether the lots there in question were acquired for and pertaining to the operation of the railroad." The jury found this issue *against* the purchaser at foreclosure sale, and that finding was confirmed by the court upon the ground that it was properly a question of fact for the jury. The case is authority for our contention here that the master and lower court having both found that the properties in question came under the terms of the mortgage, their finding is *conclusive* upon that subject.

In *Smith* v. *McCullough*, 104 U. S. 25, a mortgage executed by a railroad company upon its then and after-acquired "property" contained a lengthy specific description of the kind and character of property sought to be mortgaged, not, however, including bonds. The court holds that the specific description qualified the word "property" so that municipal bonds owned by the Railway Company were not covered by the mortgage. The court adds:

> Had the draftsman of the instrument stopped in his description of the mortgaged property with the general words, 'and the present and after-to-be-acquired property of or in any manner pertaining to the Linaus branch and all the right, title and interest therein,' there would be more force in the position taken by the appellant.

The case of *Boston Railroad Co.* v. *Coffin*, 50 Conn. 150, decided in 1861, also involved the construction of the language used in the after-acquired property clause of the mortgage. The language employed contained the following phrases: "That may be used in the location of said railroad"—"used as a part of said railroad"—"appertaining thereto"—"necessary for the

construction, operation or security thereof"—"necessary for the completion and operation of the road."

The court places its decision to a large extent upon the provisions of the Connecticut statute which disabled the Railway Company from holding lands not "necessary or convenient" for its purposes. The court said:

> The words "necessary or convenient" as used in the charter and mortgage should have a liberal construction and should include all that has been found to be reasonably necessary or convenient for the operation of the road since its construction.

In *Dinsmore* v. *Railroad Co.*, 12 Wis. 725 (1860), the language of the after-acquired property clause in a mortgage was construed and held not to cover a tract of 285 acres of woodland situated some seven miles from the railroad, although the land was purchased and used by the company for the purpose of supplying the road with timber and fuel.

XV.

A consideration of the Trust Company's claim that the property of the Belt Company was a trust fund to which the creditors were entitled in priority to the stockholders.

Although protesting that the plan of reorganization was a lawful, valid, and honest plan, not only by its terms, but in the manner in which it was executed and carried into effect, yet the Trust Company, in their brief (p. 28), casually refer to the Boyd case, quote from it, and refer to

> —the general proposition underlying this case, that the stockholders of the Belt, whether by agreement among themselves or by agreement with the bondholders, could not appropriate to themselves the assets of the company and leave any creditors unpaid.

Counsel studiously avoid any express claim that the so-called "creditor's equity" was fraudulently diverted from them

to stockholders, as a ground of recovery in this cause, for they fully realize that the Trust Company's participation in the plan spells disaster to that theory; but they seek to inject into their argument the doctrine of the Boyd case by referring to it incidentally, not as a ground of recovery, but under the thin disguise of an answer to what they erroneously refer to as the contentions of the Southern Company and of the master. We make no objection to the insidious manner in which it is sought to introduce this issue into the case, but it is not inappropriate to point out that it is not in harmony with the oft-repeated protestations in the Trust Company's brief that the plan of reorganization was an honest one, and that, therefore, the principles of the Boyd case are not invoked as a ground of recovery in this Court.

But the Trust Company is not in a position to say that the property of the Belt Company was a trust fund to which creditors were entitled in priority to the stockholders. That principle is only available to *non-assenting* creditors. So far as the Trust Company is concerned, it *assented* to the exchange of Southern stock for Belt stock, and the transaction was thereby shorn of any trust relation. As to the Trust Company, every paragraph in the plan was valid and binding, and so were all the steps taken pursuant to the plan, such as the exchange of stocks and bonds, the foreclosure proceedings, the foreclosure sales, the purchases by the Southern Company, and the delivering possession to it of the railroad properties involved. The law attaches no trust to the entire transaction, or to any part or parcel of it, in favor of a *consenting* creditor such as the Trust Company.

XVI.

The master's finding of the value of the Belt property was not based on the amount bid at the foreclosure sale.

It is not now claimed, and never has been claimed, that the amount bid at the foreclosure sale of the Belt property was, in the judgment of the master, controlling evidence of its value.

It is true, however, that the Trust Company, as the master found (Rec. 853), "though a party to the foreclosure proceedings, has not at any time objected to the regularity thereof, or to the *sufficiency* of the amounts received for the properties sold."

We do claim that the master had before him in the evidence contained in the record, *all* of the elements which may be properly considered in the valuation of railway properties, all as stated in our brief, p. 142 *et seq.*, and that the master, upon a consideration of all of this evidence, reached the conclusion that the fair value of the property did not exceed the bonded indebtedness of the Belt Company, which was $1,000,000. The master does not attach any significance to the amount of the bid at the judicial sale. His finding is based upon other competent and legal testimony.

Counsel say, p. 37, that the stocks of the Southern Company were issued as fully paid and non-assessable. There is *nothing* in the record to support this statement. It is then argued that it must be assumed that the value of the property was the face value of the securities issued against it, and counsel quote the constitutional provision of Missouri to the effect that:

> No corporation shall issue stocks or bonds, except for money paid, labor done or property actually received, and all fictitious increase of stock or indebtedness shall be void.

This Court has held that this constitutional provision, contained in the Constitution of Arkansas, does not apply to the

issue of stocks and bonds in the reorganization of railroad properties (*Memphis Ry. Co.* v. *Dow*, 120 U. S. 287).

Furthermore, the Trust Company was fully acquainted with all the details and purposes of the reorganization, and the terms and considerations on which the stock was issued, and became a stockholder itself. It is, therefore, in no position to urge that the face value of the securities of the Southern Company is any evidence of the value of the Belt property.

Madison Bank v. *Alden*, 129 U. S. 372.
Cunningham v. *Holley*, 121 Fed. 720.
Berry v. *Rood*, 168 Mo. 316, 334.
Meyer v. *Milling Co.*, 192 Mo. 168, 191.
Whitehill v. *Jacobs*, 75 Wis. 474.
First National Bank v. *Mining Co.*, 42 Minn. 327.
Adamant Mfg. Co. v. *Wallace*, 16 Wash. 614.

We again respectfully submit that the decree of the court of appeals should be reversed, and that the decree of the circuit court should be affirmed.

SAMUEL UNTERMYER,
SAMUEL W. MOORE,
Solicitors for Appellant and Petitioner.

December, 1915.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1958.

THE KANSAS CITY SOUTHERN RAILWAY COMPANY,

Appellant,

v.

GUARANTY TRUST COMPANY, CENTRAL IMPROVEMENT COMPANY, CARBON STEEL COMPANY OF KANSAS CITY SUBURBAN BELT RAILROAD CO.,

Appellees.

No. 39

Appeal from the Circuit Court of Appeals for the Eighth Circuit.

BRIEF, STATEMENT AND ARGUMENT FOR THE GUARANTY TRUST COMPANY

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1915.

THE KANSAS CITY SOUTHERN RAILWAY COMPANY,
Appellant,
vs.
GUARDIAN TRUST COMPANY, CENTRAL IMPROVEMENT COMPANY, CAMBRIA STEEL COMPANY AND KANSAS CITY SUBURBAN BELT RAILROAD CO.,
Respondents.
No. 85

Appeal from the Circuit Court of Appeals for the Eighth Circuit

BRIEF, STATEMENT AND ARGUMENT FOR THE GUARDIAN TRUST COMPANY

STATEMENT OF THE CASE.

This is an appeal from the Circuit Court of Appeals for the Eighth Circuit, the substantial parties to which are, the Kansas City Southern Railway Company, Appellant, and the Guardian Trust Company, Respondent. The Central Improvement Company is also an

Appellee, but is only incidentally involved in the controversy.

Among the parties to the litigation in its earlier stages, and necessary to be considered on this hearing, are the Cambria Steel Company, a corporation of the State of Pennsylvania, and the Kansas City Suburban Belt Railroad Company, called the Belt Company, a corporation of the State of Missouri.

Other corporations appearing in the history of the litigation, although not as parties, are the Kansas City, Pittsburgh and Gulf Railroad Company, called the Gulf Company, and the Port Arthur Channel and Dock Company, called the Dock Company.

The Gulf Company owned a line of railroad extending from Kansas City, Missouri, to Port Arthur, Texas, on the Gulf of Mexico.

The Belt Company owned the terminals used by the Gulf Company at Kansas City.

The Dock Company owned the terminals used by the Gulf Company at Port Arthur.

The Belt, Gulf and Dock Company, each of them, had outstanding bonds secured by mortgage upon its properties, and the financial situation was thought by those in control to justify a reorganization of these companies and the properties. This was undertaken by a committee of the holders of the bonds and stocks of the companies, and the method of it is set out at large in the report of the master (Rec., pp. 813, 824).

We must dissent at once from what is said by the appellant in the opening of its brief under the head of

The Main Question Presented by This Record.

The Trust Company contends that the plan of reorganization in addition to making provision for the stocks and bonds of the old companies, contemplated and provided for the payment of all the general creditors, and was an honest and lawful plan of reorganization, and the Circuit Court of Appeals so held.

The Southern Company, the offspring of the plan, contends that the Trust Company as an unsecured creditor is seeking to impose a liability for the indebtedness of one of the old companies to it, upon the Southern Company, "based upon the alleged fraudulent character of the reorganization plan under the rule of Northern Pacific Railway Co. v. Boyd, 228 U. S. 482," in the face of what it alleges to be certain conceded facts.

The Trust Company insists that the only fraud in the case was the refusal to perform the promise of the plan and the Circuit Court of Appeals so held.

As to the facts said to be conceded we have to say: It is conceded that the Trust Company as a bondholder and stockholder in the old companies, participated in the plan, but it is not conceded that save for the plan it would have lost its old stock.

It is not conceded, but is expressly denied that the plan contains a covenant by which the Trust Company agreed not to hold the new company for the debts of the old companies.

It is conceded that the Southern Company acquired the formal legal title to the properties of the old com-

panies at foreclosure sales had as formal incidents of the plan of reorganization and no more than this is conceded or is the fact as to such sales.

It is not conceded and it is not the fact that the "fair market value" of the Belt property at the time of the reorganization and foreclosure did not exceed the mortgage indebtedness against it.

The Plan of Reorganization

had as its declared "ultimate purpose the unification of the main line and terminals into one ownership and under one management" (Rec., p. 814), to be accomplished by having a new company, to be known as the Southern, acquire the stock and bonds of the old companies and as well their properties in fee (Rec., p. 815), and this might be done, "with or without foreclosure of either or all of said properties" (Rec., p. 823).

The Results to be Attained

were thus set forth in the plan (Rec., p. 815):

a. The new company would own the main Gulf line and the stocks and bonds of the Terminal Companies. These stocks and bonds to be pledged under the new first mortgage to be created.

b. **The payment of the floating debt and the existing Car Trust obligations.**

c. Adequate provision for working capital for future requirements.

d, e, and f. Other advantages that need not be detailed.

The Financial Scheme.

The new company was to issue $30,000,000 of bonds, $21,000,000 of preferred stock and $30,000,000 of common to be disposed of as follows (Rec., pp. 815-821).

Bonds:

Gulf bondholders at the rate of 75 per cent of their holdings	$18,000,000
Belt bondholders, at the rate of 133 per cent of their holdings	1,330,000
Subsidiary Company bondholders	3,867,500
To be sold for the necessary cash requirements of the new company	3,000,000
To be reserved for the future requirements of the new company	3,802,500
Total	$30,000,000

Preferred Stock:

Gulf bondholders, at the rate of 50 per cent of their holdings	$12,000,000
Gulf stockholders, who pay ten dollars on each share of stock deposited by them—at the rate of 10 per cent of their stock holdings	2,400,000
Bondholders of Belt and Constituent Companies, at the rate of 25 per cent of their holdings	1,012,500
Belt Company stockholders, at the rate of 25 per cent of their holdings	1,187,500

Dock Company bondholders, at the rate of 50 per cent of their holdings	817,500
To be sold for the necessary cash requirements of the new company	3,000,000
Unappropriated	582,500
Total	$21,000,000

Common Stock:

To Gulf stockholders, who paid in $10 per share—par for par	$24,000,000
To Belt stockholders, at the rate of 75 per per cent of their holdings	3,562,500
To Dock bondholders, at the rate of 50 per cent of their holdings	817,500
To Dock stockholders, at the rate of 75 per cent of their holdings	1,181,250
Unappropriated	438,750
Total	$30,000,000

So the new company would have, in addition to the stocks, bonds and properties of the old companies, cash and its own securities as follows, viz:

Cash	$2,400,000
Bonds	6,802,000
Preferred Stock	3,582,000
Common Stock	438,750

As to these assets the plan provided that $3,802,500 of bonds were for "the future requirements of the com-

pany'' which ''included such extensions, betterments, and new equipments as might be required by the business of the company'' (Rec., p. 820).

The Debts of the Old Companies

were to be provided for by the sale of $3,000,000 of bonds and $3,000,000 of preferred stock expected to realize $3,500,000 and by the $2,400,000 cash received from Gulf stockholders, this fund of $5,900,000 to be applied as follows (Rec. pp. 820, 821.):

For payment of car trusts and interest adjusted to date of payment, say	$1,900,000
For payment of floating debts	475,000
For payment of receiver's certificates	800,000
For payment first mortgage coupons, Due April 1, 1899	575,000
Working capital and expenses of reorganization	2,150,000
Total	$5,900,000

This left $582,500 of preferred stock and $438,750 of common unappropriated in any way.

All of these estimates as to indebtedness were too

low. Payments actually made on these several accounts were as follows (Rec., p. 860):

Car Trusts	$2,192,580.40
Coupons	891,913.41
Receiver's Certificates	821,543.74
Floating Debt	1,164,172.56
Total	$5,070,210.11

The amount estimated was $3,750,000.

One paragraph of the plan provided that:

> "**Any obligation in the nature of floating debt or otherwise against any company or property embraced in said plan, either as proposed or carried out, or any securities held as collateral for any such obligation, may be acquired or extinguished or held by the Committee at such time, in such manner, and upon such terms as they may deem proper for the purpose of carrying out this agreement,** and nothing in said plan and this agreement contained is intended to or shall constitute any liability or trust in favor or in respect of any such obligation acquired or extinguished or held by the Committee" (Rec., p. 823).

Another that:

> "It shall be the special duty of said Committee, which they are hereby fully authorized and empowered to perform, to prepare and adopt a plan for the reorganization of the Kansas City, Pittsburgh & Gulf Railroad Company, and its property, and also, if necessary, for the reorganization of the

Kansas City Suburban Belt Railroad Company, and the Port Arthur Channel & Dock Company and their properties, and for the consolidation of said corporations, if such consolidation can be lawfully made and is found to be practicable, either with or without foreclosure of either or all of said properties, or by means of the acquisition of the stock or other securities of either or all of said corporations, or in any other manner that may be deemed by said Committee to be most practicable and feasible; **and said Committee are authorized to negotiate with bondholders, creditors and stockholders of said companies, or either or all of them, in devising and carrying out said plan, etc.**" (Rec., p. 823).

A third that:

"The depositors hereby irrevocably request the Committee to endeavor to carry into practical operation any plan so adopted, and this agreement in its entirety, or in part, to such extent and in such manner as the Committee shall deem to be for the best interests of the depositors in the consolidation or acquisition and unification of the properties finally embraced in the readjustment * * * **to purchase at any time and at such prices as they shall deem proper, or to pay, compromise, or settle with the holders of coupon notes or other indebtedness, or car trusts or other obligations of any of the said companies * * * and to apply for that purpose any money received from the sale of stock or obligations of any new company to be formed** * * * with plenary powers to enter into ar-

rangements for decrees or for facilitating or hastening the course of litigation, or in any way to promote the consummation of said plan, etc., etc." (Rec., p. 824).

The plan of reorganization was carried into effect. The Southern Company first acquired the stocks and bonds of the old companies, and later at foreclosure sales the legal title to their physical properties. In the case of the Belt Company the Southern acquired practically all of its stock and bonds prior to April 1st, 1900, and from and after that date the officers and directors of the Belt were nominees of the Southern Company (Rec., p. 810).

By the terms of the plan the Southern Company was liable for all obligations incurred by the Committee in accomplishing the reorganization (Rec., p. 865).

The Situation as to the Belt Company.

The Belt Company had a capital stock of $4,750,000 and a bonded debt of its own of $1,000,000. Affiliated companies, the Union Terminal, Consolidated Terminal and Air Line had outstanding mortgages on their properties for $2,000,000, $750,000 and $300,000 respectively. The Belt in practical effect, through stock ownership, held the equity in these properties.

By the reorganization there was paid for the bonds of these four companies and for the stock of the Belt which carried with it the stock of the other three companies, in securities of the Southern as follows:

For the $1,000,000 of Belt bonds $1,330,000 of Southern bonds and $250,000 of preferred stock.

For the $2,000,000 of Union Terminal bonds $2,000,000 of Southern bonds and $500,000 of preferred stock.

For the $750,000 of Consolidated Terminal bonds $750,000 of Southern bonds and $187,500 of preferred stock.

For the $300,000 of Air Line bonds $300,000 of Southern bonds and $75,000 of preferred stock.

For the $4,750,000 of Belt stock $1,187,500 of Southern preferred and $3,562,500 of Southern common.

In addition the Belt Company had outstanding indebtedness of about $900,000 as to which such provision was made as is hereinbefore set forth.

The Situation as to the Trust Company.

The Trust Company held securities of the old companies as follows (Rec., p. 867):

Gulf Company bonds	$ 642
Gulf Company stock	1,327
Dock Company bonds	325,000
Dock Company stock	438,900
Union Terminal bonds	410,000
Air Line bonds	42,000
Belt Company stock	76,972

In addition the Trust Company held an indebtedness against the Belt Company on notes and open account, amounting to about $500,000 and it held stocks and

bonds and other property belonging to the Belt Company as security for this indebtedness.

It also held some unpaid coupons pertaining to its Union Terminal bonds (Rec., p. 454).

The Trust Company assented to and participated in the plan of reorganization and received for the stocks and bonds of the old companies held by it, stocks and bonds of the Southern Company in the measure prescribed by the plan.

The coupons held by it were also paid and as well a part of the indebtedness on notes and open account. The greater part of this latter indebtedness, amounting to $360,000, was not paid, first upon the ground that it was not a valid obligation of the Belt Company, and later upon the ground that neither the reorganization Committee nor the Southern Company was liable therefor.

On September 1st, 1900, the indebtedness of the Belt Company to it being overdue, the Trust Company gave notice that it would, on September 7th, sell some of the collateral that it held.

The Cambria Company

had sold and delivered rails to the Belt Company during the years 1897 and 1898 to the extent of about one hundred thousand dollars and held its note for this amount secured by collateral of the same character as that held by the Trust Company (Rec., p. 672).

The Pleadings and Proceedings.

On September 6th, 1900, the Cambria brought suit against the Belt on this note, recovered judgment, issued execution, had the writ returned *nulla bona*, filed a creditor's bill against the Belt and the Trust Company, applied for and had receivers appointed for the Belt and applied for and got a temporary injunction prohibiting the Trust Company from disposing of any of the Belt collateral held by it. The Belt and constituent companies, creatures of the Southern, appeared in these proceedings on the first day and consented to what was done (Rec., pp. 3-31).

On September 6th, 1900, the trustee of the Belt mortgage brought suit to foreclose and prayed for and got receivers appointed for the Belt property and an injunction against the Trust Company to prevent any sale or disposition of the Belt collateral held by it (Rec., p. 98).

Thenceforth justice traveled with a leaden heel and has been fifteen years in reaching this tribunal.

The Cambria Bill

alleged that while the Trust Company asserted a heavy indebtedness against the Belt, the Trust Company was in fact heavily indebted to the Belt, and it wanted an accounting and a judgment for the Belt against the Trust through which it could realize on its own judgment against the Belt.

The bill was brought by the Cambria Company "as

well for itself, as for the benefit of all other creditors and persons interested in said Belt Company, similarly situated, and willing to become parties to this action and contribute to the expense thereof'' (Rec., p. 18).

No such other creditor ever appeared although in the suit thus begun a decree was not reached in the Circuit Court until June 25th, 1910.

Trust Company's Answer.

November 5th, 1900, the Trust Company answered the Cambria bill denying its adverse allegations and vindicating its own claims against the Belt Company. It further charged in terms that the suit was a collusive one, brought at the instance of the Southern Company which had paid or promised to pay Cambria's debt and to secure it against liability for costs. It also set up that under and by virtue of the reorganization of the Dock, Gulf and Belt companies, the Southern Company was liable for the indebtedness of the Belt (Rec., pp. 33-69).

Formal Replication

to this answer was filed by the Cambria Company on December 3rd, 1900.

Proceedings in the Cambria Case.

Just what was done during the next year does not appear from the record in this court, but from and after November 20th, 1901, Cambria permitted its allies in the litigation to conduct the active operations

and for that reason asked to be relieved and was relieved by the Circuit Court from the payment of costs incurred after that date (Rec., pp. 889 and 914).

The decree of the Court, pursuant to the Master's report, dismissed the Cambria bill and that company took no appeal but acquiesced in an adjudication that on its face meant the total loss of a claim of $100,000 with ten years' interest (Rec., pp. 903-904).

Meanwhile the Trust Company had continuously asserted the liability of the Southern Company for all Belt indebtedness, and for that to the Cambria it was unquestionably liable, but Cambria never asserted such liability in any legal proceeding.

The Court of Appeals said that "it is difficult to wink so hard as not to see that the Cambria suit was in reality the suit of the Southern Company."

The Belt Foreclosure.

In this suit the Trust Company made repeated application for leave to defend, and to set up the liability of the Southern Company for the Belt debts, which was denied, upon the condition, however, made a part of the decree of foreclosure, that the decree should "be without prejudice to and shall not bar the right of the Guardian Trust Company or its receiver, to plead and insist in any litigation now pending or hereafter brought, that the Kansas City Southern Railway Company, by virtue of the manner in which it was organized, or for any other reason is legally or equitably

liable for and bound to pay the unsecured debts of the Kansas City Suburban Belt Railway Company, etc., etc." This was on November 6th, 1901 (Rec., p. 867).

Proceedings by Belt Company and Its Receivers.

At some time not disclosed by the record, the Belt Company and its receivers filed a cross-bill in the Cambria suit. It is not contained in the record and was withdrawn or dismissed (Rec., p. 890).

November 20th, 1901, they filed an ancillary bill which was largely a replica of Cambria's bill (Rec., pp. 97-113). Cambria on December 16th, 1900, admitted the ancillary bill to be true (Rec., pp. 156-157). It was answered by the Trust Company on December 9th, 1901 (Rec., pp. 115-155).

March 22nd, 1905, the Belt and its receivers filed an amended and supplemental ancillary bill (Rec., pp. 201-265). The Trust Company answered this June 1st, 1905 (Rec., pp. 312-382).

July 2nd, 1906, the Belt and receivers filed a second amended and supplemental ancillary bill of complaint (Rec., pp. 392-460), which was answered by the Trust Company on the same day (Rec., pp. 461-467).

Formal replications to the answers of the Trust Company were filed.

Proceedings by the Southern Company.

On February 7th, 1905, it was stipulated that the Southern Company should become a party to the suit

"either as a joint complainant, or by bill of intervention as it may elect" (Rec., p. 164).

February 27th, 1905, the Southern Company filed its petition of intervention (Rec., pp. 166-186), and the Trust Company answered March 7th, 1905 (Rec., pp. 186-201).

May 1st, 1905, the Southern Company filed its amended petition of intervention (Rec., pp. 267-291) which was answered by the Trust Company May 20th, 1905 (Rec., pp. 292-312).

Formal replications to the answers of the Trust Company were filed.

These various polyonymous bills and petitions of the Cambria, the Belt and its receivers and the Southern Company made elaborate charges against the Trust Company to the effect that it was heavily indebted to the Belt Company and on various grounds sought to deprive it of the Belt collateral which it held and moreover to get judgment against it for the amount alleged to be due from it to the Belt.

By its answers the Trust Company met the allegations against it, in each and all asserted its claims against the Belt Company, its right to the collateral held by it, and the liability of the Southern Company for the Belt debts.

In the answers to the bills of the Belt Company and its receivers, the Trust Company prayed judgment for what might be found due to it upon an accounting, but in the answers to the petitions of intervention by the

Southern Company the only relief prayed for was the dismissal of the petitions.

Suits in the State Courts.

In 1905 and 1906 the Trust Company instituted suits at law in the State courts of Missouri against the Southern to recover from it the Belt indebtedness. These suits were enjoined by the Circuit Court, but on appeal the injunction was dissolved by the Court of Appeals, 146 Fed. 337. Later a second injunction was obtained by the Southern against the prosecution of these suits and this injunction was also dissolved on appeal by the Circuit Court of Appeals on April 2nd, 1909. See 171 Fed. 43.

The Master's Report.

During the long pendency of the case before the Master, testimony to the extent of 36,000 typewritten pages was taken, but none of this, save some excerpts in the report, is contained in the record before this Court.

May 2nd, 1910, the Master made his report in which he found in favor of the Trust Company on all its claims against the Belt, save as to three items, and recommended judgment accordingly (Rec., p. 888). He found against all the claims made by the several complainants on behalf of the Belt against the Trust Company. He found in favor of the Southern Company that lands of the Central Improvement Company whose stock was held by the Trust Company as collateral to the Belt debt passed to the Southern Company under

the after acquired clause of the Belt mortgage (Rec., p. 887), and further (Rec., p. 887) "that the Southern Company is not liable in any way for the floating indebtedness of the Belt Company."

Exceptions.

The Trust Company filed exceptions to the report so far as it was adverse (Rec., pp. 892-894). The exceptions as to the finding on the liability of the Southern for the Belt debts are challenged as formally defective and insufficient to save the question for review, and they will be set out at length under the appropriate head of the argument.

The Decree.

The report of the Master was approved in all things on June 25th, 1910, and judgment and decree were entered accordingly. The judgment was for $639,658.56. As the claims were ten and more years old, the judgment is in large part made up of interest (Rec., pp. 903-915). The collateral held by the Trust Company was adjudged to be rightfully held by it as security for the debt but the value was taken out of the 1,120 shares of the stock of the Central Improvement Company by awarding its lands to the Southern Company. The decree absolved the Southern Company from any liability for the Belt debts.

From this decree only the Trust Company and the Central Improvement Company appealed. The assignments of errors need not be considered unless in

connection with the exceptions to the Master's report alleged to be insufficient.

The Case in the Court of Appeals.

The Court of Appeals, overruling the objections to the formal sufficiency of the exceptions to the Master's report, considered the case upon its merits and upon each of two hearings decided the questions involved in favor of the Trust Company. Central Improvement Co. v. Cambria Steel Co., 201 Fed. Rep. 811, and same case, 210 Fed. Rep. 696. Copies of the opinions have been filed here. On the second hearing the Court in view of all the circumstances of the litigation, the expense incurred and the great delay already suffered, gave affirmative relief to the Trust Company notwithstanding the informality of the pleadings.

The Appeal to This Court

challenges the right of the Trust Company to review the report of the Master or the decree of the Circuit Court on the ground of the insufficiency of the exceptions to the report and asserts that no liability for the Belt indebtedness was assumed for or by the Southern Company; that the Trust Company is estopped from alleging any such liability because of its participation in the plan of reorganization, and by a covenant that it would not hold the new company for the debts of the old; that the Belt property was not worth the mortgage indebtedness against it and so the Trust Company was not injured by the reorganization; and that

in any event the Trust Company should in the measure of its recovery be limited to such equitable terms as this Court may think should have been offered to creditors under the reorganization. It also insists that the Central Company lands were subject to the Belt mortgage and that the Trust Company had no right to such lands as against the mortgagee.

It will avoid repetition to set forth the facts of the case in the course of the discussion of the several questions involved.

It was contended by the Southern Company in the Circuit Court and the Court of Appeals that the Trust Company was barred by

Laches.

We had supposed that this contention was abandoned in this court, but find that the brief of the appellant deals quite extensively with the opinion of the Court of Appeals on this subject under the head of "supplemental statement to correct certain misconceptions on which the Court of Appeals based its decision."

Without following appellant throughout the details of this statement we call attention to some facts which amply justify the conclusion of that Court that there was no sleeping upon its rights by the Trust Company and that the great delay in this case was in truth occasioned by the Southern Company and its allies.

The Trust Company made claim for a large amount against the Belt Company and the Southern and was

interested in the prompt payment of the claim, for it was itself placed in the hands of a receiver in the course of this litigation.

It sought to get payment of the claim before any litigation was begun in June, 1900, but an investigation of the accounts was insisted upon on behalf of the Southern Company (Rec., p. 863).

Payment not having been made on September 1st, 1900, the Trust Company gave notice that on the 7th day of September, 1900, it would sell certain collateral that it held.

On the 6th of September, 1900, the Cambria filed its suit and on the same day receivers were appointed for the Belt Company, and a restraining order was issued preventing any sale of the collateral by the Trust Company (Rec., pp. 28-31). A temporary injunction followed upon this which was not dissolved until June 25th, 1910 (Rec., p. 904).

The bill of the Cambria Company was answered by the Trust Company on November 5th, 1900 (Rec., p. 32). The Belt Company and its receivers filed a cross-bill some time before November 12th, 1901, which was withdrawn or dismissed on that date.

Meanwhile the Trust Company endeavored to become an active party to the Belt foreclosure suit but was denied the right (Rec., p. 867).

November 20th, 1901, the Belt Company and its receivers filed an ancillary bill (Rec., p. 97); an amended and supplemental ancillary bill on March 22nd, 1905

(Rec., p. 201), and a second amended and supplemental ancillary bill July 2nd, 1906 (Rec., p. 392).

These bills were all promptly answered by the Trust Company.

The Southern Company did not appear in its own name until February 7th, 1905, filing its petition of intervention February 27th, 1905 (Rec., p. 166), and its amended petition on May 1st, 1905 (Rec., p. 267).

The appellant says that some of these various bills were filed pursuant to stipulation. So be it. But that did not make them the bills of the Trust Company, nor did it make the delay in presenting them the delay of the Trust Company. And in stipulating that they might be filed instead of resisting the filing, the Trust Company simply prevented further delay.

And it is quite apparent that the great mass of the 36,000 typewritten pages of testimony must have been taken on issues presented by the Southern Company and its allies and determined against them.

Other criticisms of the opinion of the Court of Appeals are met in the course of the argument and need not be noted here.

There is a motion by appellee to dismiss the appeal. As to this we refer to the brief which accompanies the motion.

POINTS AND AUTHORITIES.

I.

The property of the Belt Company was a trust fund to which the creditors were entitled in priority to the stockholders.

Central Improvement Co. v. Cambria Co., 201 Fed. Rep. 811;
Same v. Same, 210 Fed. Rep. 696;
Northern Pacific Ry. Co. v. Boyd, 228 U. S. 482.

II.

The amount bid at the foreclosure sale of the Belt property was no evidence of its value.

Investment Registry v. C. & M. E. R. Co., 212 Fed. Rep. 594;
Northern Pacific Ry. Co. v. Boyd, 228 U. S. 482;
Section 8, Article 12, Constitution of Missouri;
Section 962, R. S. of Missouri, 1899;
Shickle v. Watts, 94 Missouri 410;
Moffit v. Hereford, 132 Missouri 513;
Louisville Trust Co. v. Louisville Railway Co., 174 U. S. 674.

III.

The plan of reorganization provided for the payment of the debts of the old companies.

IV.

The estimate as to the floating debt was not intended as a limitation upon the amount to be paid under the plan.

V.

The provision for the payment of debts made by the plan was not limited by the interests of the bondholders.

VI.

There was no exclusion of creditors who were also bondholders and stockholders.

VII.

All the creditors save the Trust Company were paid and the Trust Company was paid in part.

VIII.

The Trust Company was entitled to enforce the provisions of the plan as a contract made for it's benefit.

Second National Bank v. Grand Lodge, 98 U. S. 123;

Johns v. Wilson, 180 U. S. 440;

Section 1729, R. S. of Missouri, 1909;

Meyer v. Lowell, 44 Missouri 328;

Beattie Mfg. Co. v. Clark, 208 Ibid 89.

IX.

There was no covenant by the Trust Company that it would not hold the new company for any of the debts of the old.

Webster v. Ins. Co., 53 Ohio State 558;

Hobbs v. McLean, 117 U. S. 567;

United States v. Central Pacific, 118 U. S. 235;
Noonan v. Bradley, 9 Wall. 394.

X.

The Trust Company not barred as a creditor by participating in the plan as bondholder and stockholder.

XI.

The Southern Company liable as being a consolidation of the old companies.

Section 1059, R. S. of Mo. 1899;
Leavenworth County v. R. R. Co., 134 U. S. 688;
State ex rel. v. Lesueur, 145 Mo. 322;
Evans v. Interstate, Etc., Co., 106 Mo. 594;
Wells v. Electric Co., 108 Mo. App. 607;
Barrie v. United Railways Co., 138 Mo. App. 557;
Johnson v. United Railways Co., 247 Mo. 326;
C. S. F. & C. Ry. Co. v. Ashling, 160 Ill. 373;
Shadford v. Detroit, Etc., Ry. Co., 130 Mich. 300

XII.

The "Equitable Terms of Recovery" now suggested by the Southern Company are very inequitable.

XIII.

The lands of the Central Improvement Company did not pass under the after acquired property clause of the Belt mortgage.

Humphreys v. McKissock, 140 U. S. 304;
Pardee v. Aldridge, 189 U. S. 429;
Smith v. McCullough, 104 U. S. 25;

Railroad v. Coffin, 50 Conn. 150;
Densmore v. Railroad, 12 Wis. 649.

XIV.

Even though the exception to the Master's report did not formally and directly challenge the correctness of his finding, which was one of law, that the Southern Company was not liable for the indebtedness of the Belt Company, nonetheless in the circumstances of the case it was competent and proper for the Court to consider and determine the question upon its merits.

Guardian Trust Co. v. K. C. Southern Co., 201 F. R. 811;
Central Improvement Co. v. Cambria Co., 210 F. R. 696;
Sheffield Ry. Co. v. Gordon, 151 U. S. 285;
17 Enc. Pl. and Prac., 1048;
2 Daniel Chanc. Pl. and Prac., 1314;
Himley v. Rose, 5 Cranch 313;
Burke v. Davis, 81 Fed. 907;
Celluloid Mfg. Co. v. Cellulite Mfg. Co., 40 Fed. 476;
Gordon v. Lewis, 2 Sumner 143;
Brooks v. Robinson, 54 Miss. 272;
Haymond v. Murphy, 65 W. Va. 616;
Webster v. Cadwallader, 133 Ky. 500;
Lehman v. Powe, 95 Miss. 446;
Von Phalen v. Winterbotham, 203 Ill. 202.

XV.

There is no reason of law, policy or morals for preferring stockholders to general creditors in the reorganization of railroad properties.

ARGUMENT.

I.

The property of the Belt Company was a trust fund to which the creditors were entitled in priority to the stockholders.

The so-called reorganization of the Dock, Gulf and Belt Railroads meant the liquidation of these old proprietary companies, by agreement of their bondholders and stockholders. They formed a new company, the Southern, which acquired the bonds and stocks of the old companies by issuing in exchange therefor its own bonds and stocks. After it had thus acquired the stocks and bonds it acquired the legal title to the physical properties of the old companies at foreclosure sales under the mortgages securing their bonds as contemplated in the plan of reorganization.

There were some provisions of the plan relative to floating debts, but it is insisted by the appellant and it was reported by the Master that these were exclusively for the benefit of the bondholders and stockholders of the old companies, who became the stockholders of the new company and that the creditors could take no advantage of them. In other words, the reorganization eliminated the general creditors.

The Belt Company had a bonded debt of $1,000,000, a floating debt of several hundred thousand dollars, a

capital stock of $4,750,000, and against these liabilities and this capital stock it had a valuable railroad property, and owned the stock of other companies.

Under the reorganization as carried out the bondholders of the Belt got $1,330,000 of Southern bonds and $250,000 in Southern stock, preferred. Its creditors other than the Trust Company, were all paid and its stockholders got $4,750,000 of Southern stock, 25 per cent preferred and 75 per cent common. Then the Southern foreclosed the Belt mortgage and bought in the property for the face of the bonded debt, leaving a deficiency on account of unpaid interest and this it is said left nothing for the unpaid general creditor.

The railroad which once belonged to the Belt Company now belonged to the Southern; those who had been Belt bondholders were now bondholders of the Southern and those who had been stockholders of the old company were now stockholders of the new, and all in due proportion, but there was no transference of general creditors. Same railroad, same bondholders and same stockholders, but a new railroad company and no general creditors.

This is what the petitioner and the Master say was accomplished and they say further that it is valid and binding upon the creditors.

We deny that this was intended to be done, and we deny its legality if it was done. And first as to the legal proposition.

Accepting for the present the view that nothing in

the plan of reorganization was intended for the benefit of the general creditors of the Belt, and we have the fact in the liquidation of the Belt Company that there was $1,187,500 of Southern preferred and $3,562,500 of Southern common stock paid to the Belt stockholders as such and for their stock, which had and could have no value save as it represented the equity, over and above the bonded and other debt, in the Belt railroad. These Southern stocks in fact paid for this equity in the Belt property, were assets of the Belt Company and subject to the payments of its debts, but this fund was taken from the creditors and divided among the stockholders. It was done by people who dealt with themselves in a dual relation as both purchasers and sellers of the same property. This was true when the exchange of stock was made and it was equally true when the Southern bought the railroad itself at the foreclosure.

We do not question that what the bondholders got was fairly their due, but what was paid above this by the Southern Company, belonged, to the extent of their debts, to the general creditors unless they were otherwise provided for. And the Circuit Court of Appeals so held on both hearings of this case. Central Improvement Co. v. Cambria Steel Co., 201 Fed, Rep. 811, and same case, 210 Fed. Rep. 696. At the time the first opinion was delivered the Boyd case had not been decided by this Court, but before the opinion in the second case was announced the decision in the Boyd case

had been handed down. Northern Pacific Ry. Co. v. Boyd, 228 U. S. 482. In view of the very thorough consideration given to the question in that case, a discussion or even citation of authorities is unnecessary and we shall content ourselves with such quotations from the opinion of Mr. Justice Lamar as are pertinent to the different phases of the case at bar. It is said, page 502:

> "Corporations, insolvent or financially embarrassed, often find it necessary to scale their debts and readjust stock issues with an agreement to conduct the same business with the same property under a reorganization. This may be done in pursuance of a private contract between bondholders and stockholders. And though the corporate property is thereby transferred to a new company, having the same shareholders, the transaction would be binding between the parties. But, of course, such a transfer by stockholders from themselves to themselves cannot defeat the claim of a non-assenting creditor. As against him the sale is void in equity, regardless of the motive with which it was made. For if such contract reorganization was consummated in good faith and in ignorance of the existence of the creditor, yet when he appeared and established his debt, the subordinate interest of the old stockholders would be still subject to his claim in the hands of the reorganized company. Cf. San Francisco & N. P. R. Co. v. Bee, 48 Cal. 398; Grenell v. Detroit Gas Co., 112 Mich. 70, 70 N. W. 413. There is no difference in principle if the contract reorganization, instead of be-

ing effectuated by private sale, is consummated by a Master's deed under a consent decree."

This is conclusive upon the general proposition underlying this case, that the stockholders of the Belt whether by agreement among themselves or by agreement with the bondholders, could not appropriate to themselves the assets of the Company and leave any creditors unpaid.

II.

The amount bid at the foreclosure sale of the Belt property was no evidence of its value.

The foreclosure proceedings do not alter the case for as carried out they were the merest formality. The Southern Company at that time owned practically all of the bonds and stocks of the Belt Company. It was at once, so far as interest was concerned, the complainant and the defendant in the action.

The Trust Company, it was argued by counsel for the Southern before the Court of Appeals, "did not intervene at any time in the Belt foreclosure suit. **It was made a party defendant in the foreclosure bill solely for the purpose of establishing by judicial decree that it had been removed as trustee under the mortgage.**"

It did make repeated endeavors to become a party for the purpose of making full defense to that suit and asserting all its rights therein but upon objection by the complainant was excluded from so doing.

It was confessedly no longer trustee in the Belt mort-

gage, it did not deny the validity or priority of the bonded debt, and so it was held that the rights it claimed as against the Southern could be conserved otherwise and this was provided for by the stipulation which was made a part of the decree of foreclosure (Rec., p. 867). This stipulation was intended to and did operate to prevent the Belt foreclosure proceeding from being a bar against the Trust Company in this or any other litigation in respect of the liability of the Southern Company for the Belt Company debt.

In fact the real foreclosure had already been accomplished. The consideration to be paid for the Belt properties was fixed by the plan of reorganization, creditors to be paid in money, bondholders to receive new bonds and stocks, and stockholders to receive new stocks, and all payments had been made, except to the Trust Company as to which a dispute had arisen —how much, if anything, was due to it and whether in fact it was not largely indebted to the Belt Company.

The Master found (Rec., p. 853) that "there is no sufficient proof in the record to show that the Belt properties, sold under the mortgage foreclosures, were worth anything in excess of what they brought at the sale; **and in the absence of such proofs, the Master finds that the amounts, for which they were respectively sold, was and is their fair market value at that time.**"

The amount bid at the foreclosure sale was one million of dollars, the face of the bonded debt. This was

the only bid made and it was made by the Southern Company, which both owned and owed the debt and both bought and sold the property. Under such circumstances the auction is a farce. As was said by the Circuit Court of Appeals of the Seventh Circuit in Investment Registry v. C. & M. E. R. Co., 212 F. R. 594, *l. c.* 610:

> "If, in Northern Pacific Ry. Co. v. Boyd, 228 U. S. 482, 33 Sup. Ct. 554, 57 L. Ed. 931, an outside combination, in competition with the reorganization committee, had been confirmed as the purchaser at $61,500,000 we can hardly conceive that Boyd would have been permitted to go behind the sale. But, because the purchaser had created the masterful situation of controlling the sale, because the purchaser was not a stranger but the virtual owner of the property exposed for sale, neither the principle of the 'stability of judicial sales' nor 'compliance with the forms of law' nor the intent to commit 'no fraudulent act' was sufficient to stop a court of equity from inquiring whether an 'undue or unfair advantage' had been taken."

But the Master made another finding based not upon the absence, but upon the presence of proofs and these of the most cogent character. He reports:

> "The union, or combination, of all the roads of the Belt System and Gulf road into the Southern Company, pursuant to the reorganization scheme, created and gave to the reorganized system a much larger value than was the aggregate value of all

said roads as separate institutions, managed as they were prior to the date they were sold to the reorganization committee; and, further, that, by reason of the additional value given to said properties as parts of the reorganized railroad system, the Southern Company was enabled to issue its thirty million dollars of bonds, twenty-one million of preferred stock and thirty million of common stock, the whole aggregating eighty-one million, par value, and approximately more than four times the amount paid by the committee for said properties at the foreclosure sales thereof" (Rec., p. 853).

When this union or combination of the properties was effected and by the very act of effecting it, the Southern Company became the owner of the bonds and the bonds were thereby in practical effect extinguished. The Company could get the legal title either by having the old companies execute a deed thereto, or it could proceed by foreclosure. But the bid it made at the foreclosure sale no more than the consideration it might express in the deed would change the fact that the Belt equity was believed to be worth $4.750,000 of Southern stock and that this large value was in fact paid therefor. And there is no intimation anywhere that there was a diminution of this value between the time when it was appropriated by the stockholders and the time when the railroad itself was sold under foreclosure.

The Master, however, is of opinion that this value

was an incident of the plan of reorganization and so might be disposed of as the authors of the plan saw fit, give it to the stockholders if they chose, even though the creditors were left unpaid. He says:

> "That, for their mutual protection and self interest, the bondholders interested in all the railroad companies involved, had the right to combine together for the purpose of acquiring all the properties thereof, and then uniting them in one system, and without consulting either the stockholders or creditors of the constituent companies owning such railroads; and, furthermore, that it was competent for the bondholders to use the stocks and bonds of the new company as they saw fit, provided, that it is not shown that in so doing, it was part of their scheme to give something of value to the stockholders that should have gone to the creditors" (Rec., p. 853).

And as he finds nothing in the record to show that "the reorganization scheme in any way deprived the unsecured creditors of any rights they would otherwise have had in case such scheme had never been consummated," he concludes that it was entirely proper to exclude the general creditors from any benefits of the reorganization.

The value which supported so large an issue of stock the Master found was a value which the Belt road had as a terminal of the Southern and which it might not have posessed as a disrupted fragment of the system. Be that as it may, the value inhered in the Belt prop-

erty. It had been and in fact was a part of the system, the whole of which was made up of the Belt, the Gulf and the Dock roads. The combination of the properties was not even a new thought, but a development of the existing status. The reorganization plan dealt with the three properties as constituting one system, and the formal foreclosure of the separate parts, affected neither the value of the property nor the rights of the various parties thereto. As was said in the Boyd case, *l. c.* 504, "any device, whether by private contract, or judicial sale under consent decree, whereby stockholders were preferred before the creditors, was invalid."

In the Boyd case the reorganization agreement recited expressly that the property to be purchased was agreed to be "of the full value of $345,000,000 payable in fully paid non-assessable stock, and the prior lien and general lien bonds to be executed and delivered" thereunder.

The equivalent of that recital is in the present case. The stocks here issued were issued as fully paid and non-assessable. The Constitution and statutes of Missouri prohibited this unless it was for value received. Section 8 of Article 12 of the Constitution provides, that:

> "No corporation shall issue stocks or bonds, except for money paid, labor done or property actually received, and all fictitious increase of stock or indebtedness shall be void."

The statutes of Missouri, in force at the time, Section 962, R. S. 1899, repeat the Constitutional provision.

As these provisions of the Constitution and statutes are construed by the Supreme Court of Missouri, when the stock is paid in property, the property must be the fair equivalent in value of the stock issued therefor. Shickle v. Watts, 94 Mo. 410. It follows from this that in the absence of direct testimony the market value of stock in a Missouri corporation is presumed to be its par, and the Supreme Court so holds. Moffit v. Hereford, 132 Mo. 513.

The issuance of stock in the present case as fully paid was tantamount to the agreement in the Boyd case that the property acquired was of the full value of the securities against it. If it was not substantially so, there was a gross fraud upon the State in the reorganization and the Southern Company may not invoke the fraud upon the State to protect it against the consequences of the fraud upon the Trust Company.

So for the purpose of this case the equity in the Belt Company stands at the value of the stocks, preferred and common, issued against it. And here again is in point what was said in the Boyd case, *l. c.* 508:

> "The fact that at the sale, where there was no competition, the property was bid in at $61,000,000, does not disprove the truth of the recital, and the shareholders cannot now be heard to claim that this material statement was untrue, and that as a fact there was no equity out of which unsecured creditors could have been paid, although there was a value which authorized the issuance of $144,000,000 fully paid stock. If the value of the road jus-

tified the issuance of stock in exchange for old shares, the creditors were entitled to the benefit of that value, whether it was present or prospective, for dividends or only for purposes of control. In either event it was a right of property out of which the creditors were entitled to be paid before the stockholders could retain it for any purposes whatever."

But there is in this case substantial evidence that the stock of the Southern Company possessed substantial value. The stockholders of the old Gulf Company were not permitted to come in under the plan unless they paid ten dollars a share on their stock. Turning in ten shares of old stock and paying in one hundred dollars in cash the Gulf stockholder got ten shares of Southern common and one share of preferred. Turning in ten shares of common stock the Belt stockholder got seven and a half shares of Southern common and two and a half shares of preferred. Manifestly then the ten shares of the Belt common were worth more than the ten shares of Gulf common plus one hundred dollars of cash, for they were worth two and a half shares of Southern preferred as against one allowed to the Gulf stock plus the cash and nearly as much Southern common as well. So the Court of Appeals held very properly that the Belt shares must have been worth at least as much as the cash per share which the Gulf shareholder paid in, making a total of $475,000, and in reality were worth much more. The appellant in its brief deals with this estimate of the Court of Appeals at

times as if it was an estimate of the full value of the Belt stock, but it is put by the Court as an absolutely irreducible minimum of value.

The market reports show a much greater value. The petition for certiorari states at page 10 that "the present market value of the preferred stock (Southern) is $57.50. On that basis the value of the preferred stock alone issued to Belt shareholders is $682,812.50. The market value of Southern common at the lowest quotation at the same time was $23 per share, or for the entire amount issued to Belt stockholders $818,375, making a total value received by the Belt shareholders of $1,501,197.

As we are in the market, let us go back to the time of reorganization, eliminating all prospects, back to the year 1900, when the debt to the Trust Company stood at $360,000. The average market price of the preferred stock for the year was $33.75 and for common $10.87 which meant to the Belt shareholders.

11,875 preferred shares at $33.75	$400,781.25
35,625 common shares at $10.87	387,243.75
Total	$788,025.00

Again more than twice the amount of the unpaid Belt indebtedness. If the highest quotations for 1900 are taken the value paid to the Belt shareholders would stand at a million dollars.

And aside from market quotations and presumptions, the plan of reorganization itself shows that the Belt

property had a great and distinctive value as related to the securities outstanding against it. The Belt Company was in better financial condition than any other of the old companies. Its bonds and stocks were paid for at a much higher rate than those of any other company.

It is said in appellant's brief, page 148, "that the stock of the Southern Company represented six companies having a total bonded indebtedness of $29,685,000, of which the Belt Company with its bonded indebtedness of $1,000,000 was three and one-third per cent. **It is quite possible, and in the light of the finding of the Master as to the value of the Belt property, practically conclusive, that whatever value attached to the stock of the Southern Company which was received by the Belt Stockholders was derived from the five companies other than the Belt Company.**"

This is in the very teeth of the facts. The plan of reorganization is an agreement of the bondholders and stockholders of all the companies, and it fixed the relative values. The Southern Company issued in exchange for the bonds of the old companies $23,197,500 of its own bonds and of this amount $1,330,000 or 5.7 per cent instead of 3.1-3 were issued to Belt bondholders. It issued $17,417,500 of preferred stock in exchange for bonds and stocks of the old companies and of this the Belt people got $1,437,500 or 8.2 per cent instead of 3 1-3. It issued in exchange for stock and bonds of the old companies $29,561,250 of its common stock and of

this Belt shareholders got $3,562,500 or more than 12 per cent and not three and one-third. These actual percentages of allotment cannot by any sort of sophistry be equated down to three and one-third.

And this is not all. Three other companies are to be taken into account as constituents of the Belt, for the Belt owned all their common stock and so whatever value there was in the equities in their property gave value to the Belt stock. These companies were the Union Terminal, the Consolidated Terminal, and the Air Line. The bondholders of the Union Terminal got for their $2,000,000 of bonds a like amount of Southern bonds and $500,000 of Southern preferred stock. The bondholders of the Consolidated for their $750,000 of bonds got a like amount of Southern bonds and $187,500 of Southern preferred. The bondholders of the Air Line for $300,000 of bonds got a like amount of Southern bonds and $75,000 of preferred stock. So taking all the Belt Terminal properties and the holders of bonds and stock against them got of the Southern bonds and stocks issued in exchange for old stocks and bonds, more than fourteen per cent of the bonds, more than twelve per cent of the preferred stock and more than twelve per cent of the common.

As compared with the securities of the other companies those of the Belt were held at a large premium, and the equities in its properties were held to be more valuable than the equity in any other property. The Belt did not derive value from the other companies but gave value to them.

There is a good reason for what is called reorganization rather than strict foreclosure in the case of railroad properties. The bonded debt is large, millions in amount and beyond the ability of a single individual to deal with. And it can be continued as the bonded debt of the new company. But every interest should be conserved in the order of its priority. And the creditor by solemn covenant stands ahead of the stockholder and to exclude him from the plan while including the stockholder is a palpable fraud. And so as was observed by Mr. Justice Brewer in Louisville Trust Co. v. Louisville Railway Co., 174 U. S. 674,, *l. c.* 683, "no such proceedings can be rightfully carried to consummation which recognize and preserve any interest in the stockholders without also recognizing and preserving the interests, not merely of the mortgagee, but of every creditor of the corporation."

What is appropriate to be done in any case must depend upon the facts of that case, but when in any case, the reorganization excludes, as the appellant here insists, any creditor altogether, while admitting stockholders to its benefits, the scheme to that extent is illegal, and the creditor so excluded has a claim against the new company for the full amount of his debt, unless it be shown that assets of the old company to that extent chargeable with his debt, did not exist.

And the bid made by the new company at the foreclosure sale in a friendly and formal proceeding is of no significance in this connection and does not dis-

prove the statement of value made by the issuance of large blocks of fully paid stock, and again as said in the Boyd case, *l. c.* 508, "If the value of the road justified the issuance of the stock in exchange for old shares, the creditors were entitled to the benefit of that value, whether it was present or prospective, for dividends or only for purpose of control. In either event it was a right of property, out of which the creditors were entitled to be paid before the stockholders could retain it for any purpose whatever."

III.

The plan of reorganization provided for the payment of the debts of the old companies.

The Court of Appeals decided that the plan of reorganization was not fraudulent in fact, but made provision for payment of the debts of the old companies.

Three principal companies and some subsidiaries were dealt with. The most important of the three was the Gulf, with its line of railroad, extending from Kansas City to Port Arthur. It was financially embarrassed and reorganization was deemed expedient. The Dock Company and the Belt Company must be taken into account, because they owned the terminals used by the Gulf. The reorganization was among other things to be a simplification of the relations between the three companies. It was to result in one company, which directly, or through stock holding, was to own the three, and one set of securities only, bonds and stocks of the new company, were to be issued, the bonds

and stocks of the old companies all to be taken up by the new. Foreclosure of the mortgages of the old companies might or might not be had, and in any event, were mere incidents, since provision was made in advance as to the disposition of the securities of the new company.

In addition to the stocks and bonds the plan took account of the floating debts of the old companies.

These three general interests, bonds, stocks and floating debts were duly provided for.

The bondholders, as such as a class were all to receive in exchange for their bonds, stocks and bonds of the new company. There were three separate interests of the bondholders, those of the three old companies, the Gulf, the Belt and the Dock. The Belt properties, relatively to the bonds and stock outstanding against them, were deemed the most valuable and so the holders were dealt with more liberally than were the holders of Gulf and Dock bonds, but so far as each of the old companies was concerned, its bondholders were dealt with exactly alike. Each got the same alloted ratio of the new securities. There was no sort of discrimination between them on any ground whatever. Individuals as such were not considered at all. The securities of the new company were simply issued in consideration of and in exchange for the bonds of the old. All of the bondholders were satisfied with the arrangement and there is none here to complain.

A like course was pursued with respect to the stock-

holders of the old companies. They got stock of the new company for their stock in the old. The holders of the Belt stock fared better than the holders of stock in the other companies, but again as to each of the old companies there was no discrimination between the holders of the stock. The dealing was not with individuals as such. The stock of the new company was simply issued in consideration of and in exchange for the stock of the old. All the stockholders were satisfied with the arrangement and there is none here to complain.

The floating debts were to be paid. The plan announced in terms that one of the results to be attained by it was "(b) the payment of the floating debt and the existing car trust obligations," (R. 815). And it made provision for this to be done by the new company. It set aside $3,000,000 of new bonds "to be sold for the cash requirements of the new company" (R. 816). And so, too, $3,000,000 of the new stock (preferred), was "to be sold for the necessary cash requirements of the new company" (R. 817).

It was estimated that these securities would yield $3,500,000 in cash and to this was added the $2,400,000 cash paid in by Gulf stockholders, making a fund of $5,900,000 to meet cash requirements.

These requirements were the obligation to pay the debts of the old companies, present working capital and the expenses of reorganization. The estimates as to these were thus stated in detail in the plan. (R. 820-821.)

For payment of car trust and interest adjusted to date of payment, say	$1,900,000.00
For payment of floating debts	475,000.00
For payment of receivers' certificates	800,000.00
For payment first mortgage coupons due April 1, 1899	575,000.00
Working capital and expenses of reorganization	2,150,000.00
Total	$5,900,000.00

Here again, as in the case of the stocks and bonds, the plan dealt with the obligations rather than with the individual holders. The floating debts were to be paid and not any particular creditor.

Had these estimates of the amounts required for the particular purposes specified been accurate, there could remain no doubt that the purpose of the plan was to pay all debts.

The bonds and stocks of the old companies were fixed and known quantities and so the apportionment of securities to these was made with exactness.

As to the indebtedness the estimates were all too low, and payments were actually made as follows:

Car trust certificates	$2,192,580.40
Floating debts	1,164,172.56
Receivers' certificates	821,543.74
First mortgage coupons	891,913.41
Total	$5,070,210.11

The car trusts, receivers' certificates and first mortgage coupons we may presume were all paid. There is no suggestion of any outstanding. And apparently the floating debts, except that to the Trust Company, were all paid, for no creditor came into the Cambria suit, and after ten years of standing invitation to present claims the master reported:

> "So far as this record shows, the only other indebtedness (than that of Cambria) against the Belt Company was on account of the deficiency judgment rendered in favor of the Provident Company, trustees in the Belt Mortgage, that is outside of the claims of the Trust Company against the Belt (R. 664).

The deficiency judgment in practical effect a judgment in favor of the new company against itself, was not within the contemplation of the plan, and the Cambria indebtedness had undoubtedly been taken care of in some way.

In proceeding to pay indebtedness beyond the amount of the estimates, the committee on reorganization were acting in conformity with the plan and not in contravention of it.

The thirteenth paragraph of the agreement provided that "**any obligation in the nature of floating debt or otherwise** against any company or property embraced in said plan, either as proposed or carried out, or any securities held as collateral for any such obligation may be acquired or extinguished or held by the Com-

mittee at such time, in such manner, and upon such terms, as they may deem proper for the purpose of carrying out this agreement, etc, etc" (R. 823).

Another paragraph authorized the Committee "to negotiate with bondholders, creditors and stockholders of said companies, or either or all of them, in devising and carrying out said plan" (Rec., p. 823).

Still further (Rec., p. 824), the depositors, that is, the bondholders and stockholders of the old companies, irrevocably request the committee "to purchase at any time, and at such price as they shall deem proper, or to pay, compromise or settle with the holders of coupon notes, **or other indebtedness**, or car trust **or other obligations** of any of the said companies . . . . **and to apply for that purpose any money received from the sale of stock or obligations of any new company to be formed.**"

The Master himself finds that the plan provided for the payment of the debts and reports:

> "The reorganization plan certainly then provided for the possible payment of floating debts to the extent of, at least $475,000, and out of the proceeds to be derived from the disposition of the securities of the Southern Company, and from the assessment on the Gulf participating stockholders. It is shown in the record that more than one million dollars was paid out on account of floating debts, the particulars of which are hereinafter stated."
>
> "The reorganization plan clearly shows that the

new securities, to be issued by the new company, 'will be disposed of as hereinafter stated' and that 'by this means,' that is, such disposition of the new securities, 'the following results will be attained,' that is, 'the payment of the floating debt and the existing car trust obligations,' thereby clearly meaning that, from the proceeds of the disposition of the new securities, the floating debt and existing car trust obligations were to be paid'' (Rec., p. 821).

IV.

The Estimate Of The Floating Debt Was Not Intended As a Limitation Upon the Amount to Be Paid Under The Plan.

If the estimate as to these classes of indebtedness was designed as a limitation upon the amount to be paid in one class it was so in all the classes, for the terms of the plan were the same as to each, and did not discriminate in any way.

It is somewhat singular that car trusts should be underestimated $292,000, for one would think that the books would show these with exactness, and so as to coupons which were underestimated $317,000. The underestimate however did not qualify the obligation to pay all the car trusts and coupons outstanding and the committee and its successor did not so believe. They paid and paid in full and so as to receivers' certificates.

As to floating debts the discrepancy between the estimates and actual payment was nearly $700,000. It

was natural that it should be greatest here. In this class would be personal injury and other unliquidated claims, and it would be mere conjecture what must be paid on their account. Moreover, the estimate was of the extent of the fund probably required, and many of the liquidated debts were no doubt secured by collateral. The Trust Company had collateral through the use of which it reduced the indebtedness to it from about $500,000 to $360,000. The Cambria Company also had collateral and of the same kind as that held by the Trust Company (Rec., p. 672).

Where a debt was paid by the use of the collateral the estimate would not be drawn upon at all, and if the debt was paid out of the estimate, the release of collateral would replenish the fund to the extent of its value.

The contemporaneous action of the committee construed the plan. They went on regardless of the estimate and paid every claim except that of the Trust Company. And for their action they had explicit authority in the irrevocable request of the bondholders and stockholders to buy, compromise or settle any indebtedness of the companies "and to apply for that purpose any money received from the sale of stock or obligations of any new company to be formed."

If the estimate was a limit, how was it to be applied? Was it to be first come, first served? Or was it at the pleasure of the committee, whether the limit should be observed at all? They were dealing with rights upon

one side and it could not be a matter of caprice upon the other. They had ample funds to meet every obligation. They had funds far beyond the estimate of these particular demands. They had unappropriated to any purpose $582,500 of preferred stock and $438,750 of common. And they had a reserve of $3,802,500 of bonds for future requirements also available for the payment of debts. Nor does it appear that the fund designated for cash requirements of the new company was exhausted. Certainly it was not a sufficient answer to a creditor to say, "we cannot pay you, although we have the money to do so, because we have already paid out all that we thought would be needed to pay our debts."

V.

The provision for the payment of debts is not limited by the interests of the bondholders.

In the reply brief supporting the petition for certiorari, page 6, counsel undertook to limit the scope and effect of the plan in its provisions for paying debts, saying that "the Southern Company and the Reorganization Committee actually paid $1,164,172.56 of the floating debt of all the companies, for the purpose of discharging underlying liens and making the new mortgage a first lien upon all the properties."

This is repeated in various forms at pages 16, 39 and 40 of the main brief. On page 39 of the main brief they quote the master as finding that "the purpose of the appropriation of $475,000 for the payment of float-

ing debt was * * * to make provision for the payment and discharge of such obligations as the committee find necessary to discharge, in order to relieve the properties to be included in the Southern mortgage from any liens claimed thereon or from any interference as a matter of business policy" (Rec., p. 860).

And again at page 40 they say: "It also appears from the findings of the master (Rec., p. 861) that at no time did the committee in making such estimate (of $475,000) contemplate or include therein the indebtedness of the Belt Company to the Trust Company."

But what is thus quoted is not a finding of facts by the master, as a reference to the record will show. It is his statement of what interested witnesses said was their purpose, and said after this controversy had arisen and in the course of the trial of this case. But it is not for them under such circumstances to construe the plan, that is to be done by its own terms and if we go beyond that by what was done by the parties at the time.

And this construction is manifestly absurd. The plan was for the benefit of stockholders more than for that of bondholders. The latter had nothing to lose by strict foreclosure, which if it did not give them their money, would give them the entire property discharged of all claims except such, if any there were, which were underlying liens on the property. The plan was devised to save something for stockholders, who were the very last in right and as to whom all debts, bonded or float-

ing, secured or unsecured, were charges against and virtually liens upon the property. The debts and all of them must be gotten out of the way, paid or settled, before the shareholders could come in for any interest and in recognition of this fact, it was provided in the plan that one of the results to be attained by it, second only to the grand purpose of bringing all the properties "under one corporate ownership, management and control" was "the payment of the floating debt."

VI.

No Exclusion of Creditors Who Were Also Bondholders and Stockholders.

The Trust Company was at the same time, a bondholder, a stockholder and a creditor. If the Trust Company stood alone in that triple relation and it was intended to exclude it as creditor it would have been excluded by name. If there were others in the same category the exclusion would have been by designation of the class. But the Trust Company is not barred by name, nor is any creditor barred by designation of being also a bondholder or stockholder.

The exclusion must then inhere in the very nature of the situation. But what reason is there, when framing a plan of reorganization, which deals with and provides for, bondholders, and all of them as bondholders, stockholders and all of them as stockholders, and creditors, and all of them as creditors, for excepting from any provision of the plan applicable to bondholder,

stockholder or creditor, a person who is at once bondholder, stockholder and creditor? Let the debt be what it may, on account for supplies furnished, money loaned or a judgment recovered because of a personal injury sustained. The very same bonds, the very same stock and the very same debt, held by different persons would be protected by the plan. A person holding stock in the Belt Company would get an equivalent amount of stock in the new company and a person who had lost his leg as a consequence of the Belt Company's negligence would be compensated for the injury, and if the person who lost his leg was also a stockholder, why must he either give up his stock or bear his personal injury without compensation. We see no reason in the nature of the case for imposing such an alternative, and none such is expressed in the plan.

VII.

All Creditors Save the Trust Company Were Paid, and the Trust Company Was Paid in Part.

The conduct of parties under an agreement is cogent evidence of their purpose in making the agreement.

In this case the floating debts save a large balance due to the Trust Company were paid, and payment to the Trust Company was refused in the first instance on the ground that nothing was due and that on the contrary the Trust Company was indebted to the Belt. A refusal upon this ground was no evidence of a purpose not to discharge all just obligations.

The fact however that the floating debts were paid

is challenged and the assertion of the fact is said to be without support in the record.

In the first place, the presumption in the absence of evidence to the contrary is that the floating debts of the constituent companies were paid, as otherwise the payments to the stockholders were fraudulently made.

Secondly, $1,164,172.56 was in fact paid on account of those debts (Rec., p. 860), and the presumption is that there was no arbitrary or capricious refusal to pay any debt believed to be just.

Thirdly, as to the Belt Company, and with that this case and its record are primarily concerned, the evidence shows that in February, 1900, its floating debt was approximately $900,000, of which something like $500,000 was then due to the Trust Company. The Trust Company by sale of collateral reduced the indebtedness to itself to $360,000. This, however, left about $400,000 due to third parties, of which $100,000 was due to the Cambria Company. Here was about $300,000 due to parties other than Cambria or the Trust Company. What was done as to this?

By the first day of April, 1900, the Southern Company had come into full control of the Belt Company, owning then practically all of its bonds and stocks, and it put its own people in control (Rec., p. 592). It also removed the Trust Company as trustee under the Belt mortgage, thus leaving the Provident Company as sole trustee.

On September 6, 1900, the Cambria Company brought

its suit based upon the promissory note of the Belt Company, got judgment upon it the same day and upon the same day filed a creditor's bill against the Belt and the Trust Company in which it alleged that the Trust Company was heavily indebted to the Belt, and besides held valuable collateral belonging to the Belt. This suit was brought by Cambria in its own behalf and as well for the benefit of all other creditors of the Belt similarly situated, etc. (Rec., p. 18).

Of such other creditors there were $300,000 in amount, **unless they had been previously paid.**

For all unpaid creditors then, except the Trust Company, there were now two sources to which they might look for payment, the Southern Company, which was undoubtedly liable, and the Trust Company, which was liable to the extent of its indebtedness, if any, to the Belt.

The invitation of the Cambria Company to creditors to join with it, stood open for ten years, but no one accepted it and on May 21st, 1910, the master reported:

> "The Cambria Steel Company, a judgment creditor of the Belt brought the original bill against defendants for the benefit of all Belt creditors who might wish to join therein. It was an action at law on a promissory note, dated January, 1900, and upon which judgment was afterwards rendered against the Belt Company, and from which it appears that the Cambria Company was a subsequent creditor whose debt had arisen long after the dates of the transactions which are complained of in the

second ancillary bill; and so far as this record shows, the only other indebtedness against the Belt Company was on account of the deficiency judgment rendered in favor of the Provident Company, trustee in the Belt mortgage, that is, outside of the claims of the Trust Company against the Belt'' (Rec., p. 664).

The deficiency judgment referred to was not part of the $300,000 outstanding in February, 1900, for it was not then in existence. What had become of this $300,000? The only inference fairly to be drawn from the facts as reported by the master is that the claims had been bought, paid, settled or compromised as provided in the plan of reorganization.

And now, as to the claim of the Cambria Company, reduced to judgment and on which its creditor's bill was based.

The judgment was obtained by consent. This does not impeach the validity of the original claim, which is indeed conceded on every hand. If the Cambria's bill was a true bill it had a right of recovery against the Trust Company, but only upon that condition. It had an undoubted right of recovery against the Southern Company.

On the day that Cambria filed its bill the trustee in the Belt mortgage filed a bill of foreclosure and on the same day and at the same time receivers were appointed of the Belt properties and injunctions granted against the disposition of Belt collateral by the Trust Company in both cases.

The Belt receivers first filed a cross-bill in the Cambria case, but this was withdrawn or dismissed. By stipulation filed November 20th, 1901, the receivers of the Belt Company and the Belt Company assumed active charge as complainants. On the same day they filed their ancillary bill and it was agreed, the Cambria Company consenting, that on the accounting between the Belt Company and the Trust and without further pleading, judgment should be rendered for the Trust Company and against the Belt Company, or **vice versa**, as the result of the accounting might require. The Cambria reserved the right to subject any judgment against the Trust Company to the payment of its own judgment against the Belt and to the use in its own behalf at the final hearing of any testimony taken in the case (Rec., pp. 890, 891).

Thenceforth the litigation on the complainant's side was conducted by the Belt Company, the instrument of the Southern until February 27, 1905, when the Southern came into the open with its bill of intervention, for the master reports as to this that all costs incurred by the Cambria Steel Company prior to the date of the stipulation had been paid and "from that date the accounting and taking of the testimony has been as between parties other than the Cambria Steel Company, and pursuant to such stipulation. Counsel for the Cambria Steel Company contends that no costs after that date should be taxed to that company" (Rec., p. 889).

The Cambria bill was dismissed as without merit,

but its prayer as to costs was granted (Rec., p. 914), and with this small measure of relief it seemed to be content for it acquiesced in the decree.

And yet, apparently, it had lost a valid claim of $100,000, with ten years' of accumulated interest.

And it had for nearly the entire period, ten years, of the pendency of its suit for the recovery of that claim from the Trust Company, taken no part in the conduct of the accounting upon the result of which its claim as against the Trust Company depended.

And while its claim as against the Trust Company depended upon the result of an accounting that involved from 10,000 to 12,000 items and the taking of 36,000 pages of testimony (Rec., pp. 579, 580) that same indebtedness upon known and admitted facts was a valid claim against the Southern Company.

The Cambria Company undoubtedly was protected by the Southern, not only against the costs of the litigation, but also against the loss of its claim, and so the Court of Appeals well said (Rec., p. 1045), "it is difficult to wink so hard as not to see that the Cambria suit was in reality the suit of the Southern Company."

And, so we repeat that all the floating debts of the Belt Company were paid, as it was intended originally they should be, except that to the Trust Company, and this drawn into controversy originally upon the ground that it was not a meritorious claim, was later resisted upon every ground that could be alleged against it.

Repudiation of the debt to the Trust Company was

an afterthought, a result of the controversy over the amount of that debt, for, as the record shows, the counter demands of the Southern and of the Belt enlarged with the progress of the litigation.

It must be remembered that when the plan of reorganization was pending, the debt of the Belt to the Trust Company was about $500,000 (Rec., p. 755) Under the contention now made by the Southern Company the Trust Company renounced this entire indebtedness. Counsel say, Brief, p. 95, that the Trust Company "in claiming under the plan of reorganization and accepting the benefits which it created for it at the expense of creditors, * * * thereby waived the assertion of its rights as a creditor independent of the plan and in antagonism to it." And yet on October 23, 1900, when the Southern Company had been for seven months in full control of the Belt, and when there was outstanding an injunction against the Trust Company enjoining the sale of any of the Belt collateral the Trust sold some of the collateral and received for it the sum of $110,250 which was credited on the Belt debt (Rec., p. 772). This must have been done by consent and not in violation of the injunction for the transaction is dealt with both in the master's report and in the final decree as a perfectly proper one (Rec., pp. 772 and 905).

Among the collateral held by the Trust Company to secure the payment of its Belt claims was 19,997 shares

of Union Company stock and 4994 shares of Air Line stock. Recognizing the validity of the Trust Company's claim to that extent and that it held these stocks as collateral thereto, the reorganization committee on June 6th, 1900, authorized the Mercantile Trust Company to pay $35,000 for these stocks which was done (Rec., p. 769), and the payment credited on the Belt indebtedness. At this time the Southern Company had been organized, had acquired the stocks and bonds of the Belt Company and had been in full control of that company for more than two months, its own nominees being the directors and officers of the Belt Company.

The master reports that "the primary investors in the Belt property, and who were specially active in putting through the reorganization plan" understood the transactions of the Belt with the Trust Company, **"and there has never been any complaint on the part of any of them as to such transactions"** (Rec., p. 672). The complaints, he says, all arose after the controversy between John W. Gates and others, the culmination of the controversy being the Bierce suit, in which a receiver was appointed for the Trust Company, and the suit by the Cambria. In the course of this litigation the Southern Company filed a bill of intervention on February 27, 1905, and in this alleged that the Trust Company had no right to hold as collateral the Union and Air Line Company stock mentioned above, that it in fact belonged to the Southern Company, having passed to it under the after acquired property clause

of the Belt mortgage at the foreclosure sale, and demanded from the Trust Company an accounting of the stock or its value (Rec., p. 185). And yet the Southern at the time it filed this bill owned this very stock, having nearly five years before bought it from the Trust Company through the reorganization committee, but of this no hint in the bill. This action of the Southern Company is but one of the evidences of its change of position as to its obligations under the reorganization plan and agreement.

VIII.

The Trust Company Entitled to Enforce the Provisions of the Plan as a Contract Made for its Benefit.

The master found that the Trust Company was not entitled to enforce the provisions of the plan for the payment of debts, because:

> "Neither the bondholders, stockholders, nor the Reorganization Committee owed any legal or equitable duty to the Trust Company, unless such duty can be implied in some way from the reorganization plan and agreement. The Trust Company as a creditor was not intended to be, and was not in fact, a party to the reorganization agreements, though it received benefits therefrom in the exchange of its old securities for the new ones of the Southern Company; nor does the evidence in the record show that it ever changed or altered its position in any way on account of said floating debt provisions" (Rec., p. 856).

He invokes the rule, simply one of procedure, that a person who is neither a party nor privy to a contract may not sue to enforce terms which are for his benefit, and cites the case of the Second National Bank v. Grand Lodge, 98 U. S. 123, in which the general rule is declared and applied. But this very case states that "there are confessedly many exceptions" to the rule. And, "one of them, and by far the most frequent one, is the case where under a contract between two persons, assets have come into the promisor's hands or under his control, which in equity belong to a third person. In such a case it is held that a third person may sue in his own name." There is a general review of the cases involving the rule in Johns v. Wilson, 180 U. S. 440, and it is announced that the question of the remedy in such a case was to be decided by the law of the place where the suit was brought," *l. c.* 448. The Missouri Code, section 1729 R. S., of Mo. 1909, provides that, "every action shall be prosecuted in the name of the real party in interest," and from the beginning this provision has been liberally construed.

In Meyer, et al. v. Lowell, 44 Mo. 328, the agreement was between the vendor and purchaser of a stock of goods. It was endorsed on the back of a statement of account and was as follows: "Having purchased the stock of goods of J. W. Horr. * * * I hereby assume the within account of May, Weil & Co. (the plaintiffs), so far as the same may be correct * * * and obligate myself to pay the same, or so much thereof as I may

be bound for in six months from date." The Court held that "the plaintiffs may maintain an action in their own name against the defendant upon the contract sued upon. This result involves no injustice to the defendant, but simply holds him to accountability upon his undertaking, according to its evident purpose and intent."

In the recent case of Beattie Mfg. Co. v. Clark, 208 Mo. 89, *l. c.* 106, the Court says:

> "Whatever the rule may be in other jurisdictions it has been uniformly held by this Court that a contract upon a valid consideration, made between two or more persons for the benefit of a third party, may be enforced by the party for whose benefit it is made, if he adopts it after it is made, though he is not named in the contract or may not have known of it at the time."

The contract here in question was made upon a valid consideration. It was for the acquisition of the railway properties by the Southern Company, the various interests in the property, of bondholders, stockholders and creditors to be paid for by the Southern, the bondholders and stockholders in Southern securities and the creditors in money. As such it was a valid contract, giving to everybody his due, and the entire wrong in the situation results from the refusal of the Southern Company to perform the contract as to the indebtedness of the Belt to the Trust Company.

That the Trust Company was a party to the contract

is beyond question, and is indeed, strenuously insisted upon by the appellant. But the Trust Company is divided into three parts—bondholder, stockholder and general creditor. It signed, so it is said, only as bondholder and stockholder, and so as creditor is not a party and yet construing the contract as excluding creditors, it is contended that the Trust Company as creditor may not enforce its claim, being barred therefrom because it signed the contract as bondholder and stockholder. We do not believe that the Trust Company is thus divisible and with such effect.

The Trust Company, not a fraction of it, signed the agreement and became a party to it, believing with right that it was to be paid thereunder, and payment being denied, sought to enforce it.

In the first pleading filed by it, the answer to the bill of the Cambria Company, it asserted that it was part of the plan of reorganization, "to pay off and discharge all of the floating and other unsecured obligations of all of the old companies," and that securities enough of the Southern Company were sold to accomplish this, but that the Reorganization Committee and the company "have wrongfully withheld said money and have unlawfully and fraudulently refused to apply the same to the purpose for which it was raised, to-wit, to the payment of the floating and unsecured debts and obligations of the Kansas City Suburban Belt Railroad Company, and the other companies * * * amalgamated * * * under said plan of reorganization"

(Rec., p. 40). And in its subsequent pleadings, answers to ancillary bills and petitions of intervention, it asserted and reasserted this obligation of the Southern Company in various forms.

IX.

There Was No Covenant By the Trust Company in the Plan of Reorganization That It Would Not Hold the New Company for Any of the Debts of the Old Ones.

A provision of the plan relied upon by the Southern Company as relieving it from liability for the debts of the old companies is as follows:

> "No right is conferred, nor any trust, liability or obligation (except the agreements herein contained in favor of the holders of certificates of deposit hereunder) is created by this agreement or the plan, or is assumed hereunder, or by or for any new company in favor of any bondholder or any other creditor or any holder of any claims whatsoever against the said companies, nor in favor of any company now existing or to be formed hereafter, whether such claim be based on any bonds, coupons, stocks, securities, lease, guaranty or otherwise, with respect to any security deposited under this agreement or any moneys paid to or received by the committee, or by the depositor hereunder, or with respect to any property acquired by purchase at any foreclosure sale, or with respect to any new certificates to be issued hereunder, or with respect to any other matter or thing" (Rec., p. 823).

What is the meaning of this cryptic paragraph? Appellant says in the main brief that it is a covenant by the Trust Company "that it would not hold the new company for the debts of any of the old ones," page 124. In the brief supporting the petition for certiorari, page 24, it is said to be "a distinct and unequivocal caveat that no claims against the old company could be enforced against the new company." But the words of counsel in which he now frames the covenant and the caveat are not to be found in the paragraph, nor are any other words plainly bearing a like import.

And counsel seems to be of opinion after all that the paragraph is not plain and unequivocal, for he says, page 131, that "it is a new doctrine that before the plan is subject to criticism, it must affirmatively show upon its face that creditors will not be paid." But fair dealing requires if it was the purpose that creditors should not be paid that this purpose should be affirmatively shown upon the face of the plan and not cleverly concealed in a mass of verbiage.

We agree with counsel, page 128, of his brief, that "when there was no legal obligation to pay there could be no legal presumption that payment would be made," but the converse of the proposition is true, that when there is a legal obligation to pay there is a legal presumption that payment will be made."

When the stockholders of the old company transformed themselves into the stockholders of the new and brought over to the new all the properties of the old

there was, without more, a legal obligation to pay all debts of the old companies and a legal presumption that they would be paid. If by the transformation it was intended to repudiate the debts, that intention should be made plainly manifest.

No unsuspicious mind reading the plan as formulated would have read in it any purpose of repudiation. In the forefront of it, blazoned as a result to be attained by it, was "the payment of the floating debt and the existing car trust obligations," and this is followed by the provision of ample means for the payment, and this again by grants of power to the committee iterated and reiterated through three paragraphs to buy, pay, compromise or settle any and every kind of indebtedness.

There is no agreement in this paragraph by anybody to renounce any right he may have, and if there is any renunciation it is the result of assent to a repudiation of obligations contained in the paragraph.

But there is no such repudiation. No right or liability is created by the plan, "except the agreements therein contained in favor of the holders of certificates of deposit thereunder." Only this, and nothing more. No right existing independently of the agreement is disavowed or renounced.

The provision is a very broad one. It is not confined to the Trust Company, indeed, the Trust Company is not mentioned in it, but includes everybody, bondholders, and all other creditors and, whether the claim be

based on bonds, coupons, stocks, securities, lease, guaranty, or otherwise. If it means what counsel say, then it means that the new company proposed to acquire the properties of the old companies under the plan without paying car trust certificates of more than two million dollars, coupons of nearly a million, receivers' certificates of more than eight hundred thousand dollars and other claims of more than a million, which are none of them provided for as held under the certificates of deposit, but are provided for under the floating debt provisions of the plan.

The agreements as to the holders of certificates of deposit relate to the apportionment of the bonds and stocks of the new company between the holders of the bonds and stocks of the old companies, and so if we accept the significance imputed by counsel to this paragraph, we not only ignore, but we eliminate everything else from the plan and agreement. Under his construction the plan becomes this, and nothing more, that the Southern Company will be formed with a certain capitalization of stocks and bonds which in certain ratio will be issued in exchange for the stocks and bonds of the old companies, the title to the physical properties of the old companies then to be secured by foreclosure proceedings in which the new company will be both plaintiff and defendant, with a **caveat**, that no car trusts, no coupons, no floating debt of any kind and not even receivers' certificates will be paid. If this was the plan it was a fradulent one. And the fraud

was a deliberate one, for the fraudulent purpose was but obscurely indicated in an involved and verbose paragraph, while an honest purpose to pay all creditors of the old companies was blazoned in every other paragraph of the plan. It is a peculiar feature of this case that fraud is brought into it, not by accusation, but by confession, and that the purpose of the confession is the accomplishment of the fraud.

If the purpose of the paragraph was to exclude the payment of any valid debt of the old companies, then its purpose was to exclude them all, for it speaks in the most general terms and includes "any bondholder or any other creditor or any holder of any claims whatsoever against the said companies," without qualification as to his participation in the agreement.

Ineffective the bar would be as to creditors who were not bondholders or stockholders. Was it the intent to discriminate against debts held by the bondholders and stockholders? The paragraph contains nothing of a discriminatory nature. If such was its intention, why was any provision made for paying matured coupons, $575,000 estimated therefor and $891,913 actually paid on account of them? The record does not disclose by whom all the coupons were held, but it is a fair presumption that they were held largely by the owners of the bonds of which the coupons were a part. And it does disclose, page 887, that the Trust Company held some coupons and that they were paid by the Reorganization Committee.

Bondholders and stockholders may also have held car trusts and receivers' certificates, and certainly if they did, they were entitled to be paid.

The interpretation now sought to be put upon the plan violates every recognized rule of construction.

It takes one paragraph and construes it into absolute repugnance to every other paragraph of the agreement and to the purpose declared by the agreement itself. The preliminary announcement of the plan and all the provisions as to purchase, payment, settlement and compromise of claims, which mean anything but repudiation and renunciation are eliminated.

The stock interest of the Trust Company in the Belt was relatively small, $76,972 par value, to be paid for in Southern stock. Its valid claims against the Belt amounted to $360,000, to be paid in cash. It did not intend to yield the larger claim to secure the smaller, and those with whom it dealt knew this. "It is a rule of law as well as of ethics, that where the language of a promissor may be understood in more senses than one, it is to be interpreted in the sense in which he had reason to suppose it was understood by the promissee." Webster v. Ins. Co., 53 Ohio State 558. And in the same case it is said that "if it be left in doubt, in view of the general tenor of the instrument and the relations of the contracting parties, whether given words were used in an enlarged or restricted sense, other things being equal, that construction should be adopted which is most beneficial to the promisee."

And these rules are peculiarly applicable here. The plan dealt not with individuals, but with classes, or rather with things. It offered to the bondholders, and to every one of them, new bonds upon no other condition than that he should surrender his old ones, and to every stockholder it offered in the same unconditional way, new stock for his old, and to the creditor it offered payment. And why should there be any discrimination against the man who was both a bondholder and a general creditor? His right in either relation is as high as that of any other person of his class.

The law of the land enters into every contract as a part of it and the presumption is that parties intend an observance of the law and not a disregard of it, and it is a rule of interpretation that where a contract is fairly open to two constructions, by one of which it would be lawful and the other unlawful, the former must be adopted. Hobbs v. McLean, 117 U. S., 567, *l. c.* 576. If this plan was as contended a contract between the bondholders and the stockholders to exclude the creditors it was plainly unlawful. And the construction of the contract which preserves the good faith of the parties will be preferred to that which involves bad faith by one of them. U. S. v. Central Pacific, 118 U. S. 235.

The agreement was framed by the Committee of Reorganization, the forerunner of the Southern Company, and here is pertinent what was said in Noonan v. Bradley, 9 Wall. 394, *l. c.* 407:

"If there were any doubt as to the construction which should be given to the agreement of the intestate, that construction should be adopted which would be more to the advantage of the defendant, upon the general ground that a party who takes an agreement prepared by another, and upon its faith incurs obligations or parts with his property, should have a construction given to the instrument favorable to him; and on the further ground that when an instrument is susceptible of two constructions—the one working injustice and the other consistent with the right of the case—that one should be favored which standeth with the right." (Mayer v. Isaacs, 8 Mees & W. 612).

But it is to be further observed that the Trust Company is not asserting any right created or conferred by the plan, but one that existed before and aside from it, although it is recognized in and confirmed by the plan.

The plan dealt with three classes, bondholders, stockholders and creditors. Bondholders and stockholders must be made parties to the plan, for in the dealing with them, the plan was outside their legal rights. As to the bondholders there was not to be a foreclosure and sale and payment of their bonds out of the proceeds, but a new company was to be formed and they were to exchange their old bonds for bonds of this company. This required their assent and so they were invited to become signatory parties to the plan. The stockholders were not to distribute among themselves such of the assets of the old company as might

be left after paying bondholders and creditors, but were to get stock in the new company and so they were invited in and asked to subscribe to the plan. But the creditors were to get their strict legal due, they were to be paid. And so they were not asked to sign the agreement. It was not at all necessary that they should do so.

If now the Trust Company, which was a bondholder, creditor and stockholder, had first presented its claim as creditor and been paid, or, suing upon it, had recovered judgment, and had then presented its bonds and stock for exchange, it would certainly have been entitled to the same allotment of new bonds and stocks as its fellow-bondholders and stockholders. But the order in which it asserted its rights would not determine the rights themselves. And so if it had sold its stocks and bonds and had not entered into the agreement at all, it could certainly have still enforced its claims on account of the Belt indebtedness and its assignee could have asserted every right which a bondholder and stockholder might have. There was no repugnance in the three relations and so the rights in each, might have been asserted separately by different individuals or together by one and the same person. If the provision under discussion did not create the right nor destroy it, neither could it take away any existing legal remedy upon it.

X.

The Trust Company Not Barred Because Participating in the Plan as Bondholder and Stockholder.

Counsel for the petitioner inquire, "How can it (the Trust Company) approve the transaction (plan of reorganization) sufficiently to receive the benefits therefrom and then disapprove it to the extent necessary to collect its debt? Shall it be permitted to approbate and reprobate at the same time?"

The answer is very simple, the Trust Company approves entirely of a plan which dealt fairly with bondholders, stockholders and creditors and dealt equally with the members of each class. It disapproves the refusal to perform the promise of that plan in its own case as a creditor.

The plan did not create the rights of either bondholders, stockholders or creditors. These existed before the plan was formed and must be respected by the plan. It was determined that there was enough in the properties to satisfy the bondholders, pay the creditors and give something substantial to the stockholders of the old companies and in this view the plan was framed. It proposed bonds of the new company for bonds of the old, payment of the floating debts of the old company and stock of the new company for stock of the old. New bonds were issued to take up all the old bonds, an ample fund was provided to pay the debts, and new stock was issued to take up all the old stock.

The Trust Company was a bondholder, a stockholder and a creditor of the old companies and it approved the plan. It approved the plan as to the bonds and accepted its allotment of new bonds; it approved the plan as to stock and accepted its allotment of stock; and it approved the plan as to floating debts and is ready to accept payment of the debt as provided by the plan.

But the payment of the debt to it is refused and on the ground that the plan was fraudulent. No bondholder, no stockholder and no creditor makes this objection. It is made only by the new company, the Southern, for whose benefit and in whose behalf the plan was made and which is equitably bound to the consummation of the plan. And the objection is made by way of confession and to accomplish the only fraud possible under the plan and that is the failure to consummate it. Let the debt to the Trust Company be paid and the plan will be accomplished and there will have been no fraud. Every bondholder, every stockholder and every general creditor will have been treated precisely as every other bondholder, stockholder and creditor was treated.

This manifestly equitable result is all that is involved in the Trust Company's contention, and in it there can be neither a fraud devised nor a fraud participated in by it. As bondholder it got only what every bondholder got and as bondholder it got no part of the $2,400,000 in cash, the $3,000,000 of bonds and the $3,000,000 of preferred stock set aside specifically

for the payment of creditors, to say nothing of the $3,802,502 of bonds set aside for the future cash requirements of the Company, or the $582,000 of preferred and $438,750 of common stock of the new company issued above all estimated requirements. And as stockholder it got nothing of any of these reserved funds.

Counsel say that "the reorganization plan operated to give the Trust Company as **stockholder** a benefit, a portion of which (and perhaps all) was already its own as a **creditor** of the Belt Company. Why was the Trust Company not compelled to make an election between the acceptance of a benefit (as stockholder) under the instrument, and the retention of its equity (as creditor) already its own, which was attempted to be disposed of in favor of third parties (stockholders) by virtue of the same instrument?"

The vice of this argumentative interrogatory is that it has no basis in fact. The plan did not necessarily imply that the property after satisfying bondholders, was sufficient only to pay creditors, and that therefore anything given to stockholders was taken from creditors. In such a case it might well be that a person who was both stockholder and creditor should take as creditor, for the assets belonged to creditors and to them alone. But the present case is different. Here were three heaps of securities and money, one labelled bondholders, another general creditors, and a third stockholders. And there was enough in each, and no-

body, bondholder, stockholder or creditor says otherwise. Only the Southern Company which provided the three heaps and which would get what may be left in any of them when the demands upon it are satisfied, makes complaint and its complaint is that it never intended one of the heaps for the purpose indicated by its label, that it always meant to keep that heap for itself.

Participation in the plan according to its terms involved no inconsistency and required no election on the part of any one who was alike bondholder, stockholder and general creditor. Between these relations themselves there is no repugnancy. There is no reason of law or morals why the stockholder of a company may not lend it money upon its bonds and also upon its general credit. Did the plan create any repugnancy? Certainly not among the relations themselves. Suppose there had been no case of the same individual being bondholder, stockholder and creditor, would not the plan **carried out according to its terms,** have resulted in the payment of every bondholder, stockholder and creditor, each after his kind? And if there had been refusal to pay, as provided by the plan, any individual of either class, how could that refusal have been justified? He was equitably entitled to share on the same terms with the fellows of his class, and here was the money, or the bonds or the stocks provided for him.

What difference does it make, when we are dealing

with the same plan that one person was alike bondholder, stockholder and creditor? The plan dealt with the liabilities of the old companies and provided assets enough for the new company to take up those liabilities. And it dealt with the holders of these liabilities as classes or groups, viz; bondholders, stockholders and creditors, and not as individuals. No persons were named or otherwise designated. How then could any repugnancy of relation result simply because one person had a place in two classes?

And how easily the repugnancy if it existed could have been removed. The creditor who was also a stockholder could sell his stock or his claim and then both must be paid. It certainly was designed to pay some debts of the old companies, or at least such was the representation. The presumption is that it was intended to pay all of them, because it excluded none and there appeared to be no reason for excluding any. Any person, bondholder, stockholder or creditor, be he but one or be he all of these, reading the plan had the right to assume that he was a beneficiary of the plan in each relation. The wrong of this case is not in making, but in breaking the agreement. But says the petitioner, "whenever the plan or action taken under the plan became fraudulent as to creditors, the duty immediately devolved upon the Trust Company, to elect whether to accept the benefits of the fraudulent scheme, or to retain them if they had been already received." But the scheme was not fraudu-

lent and never became so, the only fraud was in the refusal by the Southern Company to carry out the scheme. And that fraud is attempted only against the Trust Company. There is not an iota of evidence in the record to show that the various provisions of the plan for the payment of debts were mere false pretenses, to be thrown off as soon as they had served the purpose for which they were made. There is not an iota of evidence in the record to show that any creditor, other than the Trust Company was left unpaid. And the presumption is that the Southern Company, save as it may be made to appear otherwise, honestly performed its honest agreement. "The duty to tender back the fruits of an illegal and fraudulent transaction upon the discovery of fraud is an imperative duty, and is an indispensable condition to the maintenance of any action based upon the fraud" say counsel, but under what code of law or ethics is the refusal of a man to pay his debt, an act of fraud by the creditor, requiring atonement by **him**?

Here was a proposal to liquidate three companies, through means of a new company which was to take over all their properties. Of course it must pay for those properties. A direct sale for a monied consideration was out of the question, so a plan of reorganization was devised. Bondholders, creditors and stockholders of the old companies were concerned, with priority of right in the order named. The bondholders and stockholders met and agreed upon a plan. The new

company formed by them was to have a capitalization of $81,000,000 of which $30,000,000 was in bonds. The bonds and stocks of the old companies were to be acquired by exchange for bonds and stocks of the new company. This was really a dealing of the bondholders and stockholders with themselves, sloughing off the old corporate forms and taking on a new. Then the new company, under foreclosure proceedings, was to acquire legal title to the physical properties.

Of the eighty-one million dollars of the bonds and stocks of the new company there was reserved from the distribution among the old bondholders and stockholders

Of bonds	$6,802,500.00
Of preferred stock	3,582,500.00
Of common stock	438,750.00

And to be added to this fund there was $2,400,000 in cash, proceeds of an assessment made by the stockholders of the old Gulf Company. This large reserve of money, bonds and stocks was available for any uses of the new company. It was designated to be used for "the cash requirements of the new company" and for "the future requirements of the new company." Most of it, $3,000,000 of bonds and $3,000,000 of preferred and the $2,400,000 of cash was designated to be used for the cash requirements of the new company, which were specified to be payment of car trusts, payment of floating debts, payment of receivers' certificates, payment of coupon notes and working cap-

ital and expenses of reorganization. The future requirements of the company meant such extensions, betterments and equipments as the business of the company might require, and to this $3,852,500 in bonds was devoted. There remained $582,000 of preferred stock and $438,750 of common not designated for any particular use. All this reserve was available for the payment of the general floating debts, most of it was designated as for that purpose and the Committee and the new company were authorized to use it or its proceeds so far as necessary for that purpose and the payment of these debts was proclaimed as one of the primary purposes of the plan or scheme of reorganization.

The amount of the reserve which it was estimated in the plan, would be required for the payment of debts was, it is true, less than the amount of those debts as that proved to be in carrying out the plan.

But that this estimate was not designated as a limitation of the amount to be paid is made manifest by a number of considerations. No words of limitation were used in this connection. Certainly the intention was to pay all car trusts, receiver's certificates and coupon notes. And yet there was a substantial underestimate as to these. And they are yoked with the other floating debts in every provision of the plan. The lowest estimate made was naturally of the floating debts. The uncertainty was as to these; no one could tell to what extent claims made were valid, and

in many cases collateral was held, the release of which would replenish the fund. In addition to all this, the Committee on Reorganization were expressly authorized to acquire and hold or extinguish "any obligation in the nature of floating debt or otherwise" (Rec., p. 823) and to "purchase, pay, compromise or settle with the holders of coupon notes or other indebtedness, or car trusts or other obligations of any of the said companies * * * and to apply for that purpose any money received from the sale of stock or obligations of any new company to be formed" (Rec., p. 824).

Here was a lifting of the limit and devotion of the entire reserve, nearly eleven millions of bonds and stocks and $2,400,000 of cash to the payment of debts if need be. And the Committee acted accordingly and did buy, pay, compromise or settle all claims except that of the Trust Company.

What was there in this to advise any stockholder that the intention was not to pay all creditors and that therefore as an honest man he could not avail himself of the plan? Certainly some creditors were to be paid, and why not all? What principle of exclusion inhered in the situation or was suggested by the plan? Absolutely none. The plan would not be fair and could not be sustained against attack, if it did not deal alike with the members of each class of liability holders, giving bond for bond, stock for stock, and paying valid claims as provided by the plan.

If from a plan of such comprehensive scope it was

intended to exclude any, the exclusion should have been expressed in unmistakable terms. If it was intended to exclude the Trust Company as such, it should have been named in the plan. But had this been attempted it would have been futile. The Trust Company would have been entitled none the less to payments of its debt and to get its share of stocks and bonds equally with the other bondholders and stockholders. Nothing so palpably unjust and futile as this was attempted and the Trust Company assented to the plan because it could read nothing of the kind therein.

If it was intended to exclude as general creditors all those who were also bondholders and stockholders, it would have been equally futile and unjust. The other bondholders and stockholders, the members of each class got their allotment of bonds and stocks unconditionally, bonds for bonds, and stock for stock and nothing more. The plan must deal equally with every class, and could not impose onerous conditions upon a few which were not imposed upon others in like case.

The Trust Company had no reason for believing that by sharing in the plan as bondholder and stockholder it forfeited its right as creditor. It was not sharing in a plan which despoiled creditors for the benefit of stockholders. Under this plan the equity in the property was not appropriated by the stockholders, except so much of it as remained after constituting an ade-

quate fund for the payment of all debts. So the Trust Company was not bound to elect, any more than other creditors, whether it would assert its claim as bondholder, or stockholder or as creditor.

The plan was an honest one in its terms, and it never became a dishonest one for there never was a change in its terms. Nor did any "action taken under the plan become fraudulent as to creditors," so that "the duty immediately devolved upon the Trust Company to **elect** whether to accept the benefits of the fraudulent scheme, or to **retain** them if they had been already received" as the appellant contends. The wrong in this case is simply the refusal to pay the debt due the Trust Company in accordance with the promise of the plan, and the fraud in this, is the fraud of the Southern Company in which the Trust Company is not an accomplice, but the victim.

We take no refuge behind the technical requirements of the law of estoppel and find it unnecessary to considered the distinction between estoppel and quasi-estoppel. That the plan was fraudulent in the beginning and so plainly so that all who participated were chargeable with knowledge of the fraudulent purpose, or that there was a secret purpose of fraud to be worked out in its execution and that the Trust Company shared in this purpose, is not to be accepted upon the mere confession of the Southern Company, belated, unsupported and thoroughly disproven, when the very purpose of the confession is to accomplish the

purpose that is confessed. When the Trust Company is paid, the plan will have been fully accomplished and no wrong will have been done to any one.

XI.

The Kansas City Southern Railway Company liable as being a consolidation of the Gulf, Belt and Dock Companies.

The Southern Company is liable for the debts of the old companies, the Gulf, Belt and Dock as being in fact a consolidation of them. The Statute of Missouri in force at the time, Section 1059, R. S. of Mo. 1899, is as follows:

> "Any two or more railroad companies in this state, existing under either general or special laws, and owning railroads constructed wholly or in part, which when completed and connected will form in the whole or in the main one continuous line of railroad, are hereby authorized to consolidate in the whole or in the main, and form one company owning and controlling such continuous line of road, with all the powers, rights, privileges and immunities, and subject to all the obligations and liabilities to the state, or otherwise, which belonged to or rested upon either of the companies making such consolidation."
>
> "In order to accomplish such consolidation, the companies interested may enter into contract fixing the terms and conditions thereof, which shall first be ratified and aproved by a majority in interest of all the stock held in each company or road proposing to consolidate, at a meeting of

the stockholders regularly called for the purpose, or by the approval in writing, of the persons or parties holding and representing a majority of such stock. A certified copy of such articles of agreement, with the corporate name to be assumed by the new company, shall be filed with the Secretary of State, when the consolidation shall be considered duly consummated, and a certified copy from the office of the Secretary of State shall be deemed conclusive evidence thereof. The board of directors of the several companies may then proceed to carry out such contract according to its provisions, calling in the certificates of stock then outstanding in the several companies or roads, and issuing certificates of stock in the new consolidated company, under such corporate name as may have been adopted."

"Provided, however, that the foregoing provisions of this section shall not be construed to authorize the consolidation of any railroad companies or roads, except when by such consolidation a continuous line of roads is secured, forming in the whole or in the main in the same general direction; and provided, it shall not be lawful for said roads to consolidate in whole or in part, when by so doing it will deprive the public of the benefit of competition between said roads. And in case any such railroad companies shall consolidate or attempt to consolidate their roads contrary to the provisions of this article, such consolidation shall be void, and any person or party aggrieved, whether stockholder or not, may bring action against them in the Circuit Court of any county through which such road may pass, which Court shall have jurisdiction in the case and

power to restrain by injunction or otherwise. And in case any railroad in this State shall hereafter intersect any such consolidated road, said road or roads shall have the right to run their freight cars without breaking bulk upon said consolidated road, and such consolidated road shall transact the business of said intersecting or connecting road or roads on fair and reasonable terms."

"Before any railroad companies shall consolidate their roads under the provisions of this article, they shall each file with the Secretary of State a resolution accepting the provisions thereof, to be signed by their respective presidents and attested by their respective secretaries, under the seal of their respective companies, which resolution shall have been passed by a majority vote of the stock of each, at a meeting of the stockholders to be called for the purpose of considering the same, sixty days' public notice of the time, place and purpose of such meeting having been given by advertisement in some newspaper printed in the county where the general offices of said company or companies of this State are situated."

As contained in the statutes the section is not divided into paragraphs and we have made the division only for the sake of convenience in the consideration of it.

The first paragraph prescribes the conditions under which consolidation may be made and the effect; the second prescribes how it may be done; the third prescribes conditions under which it may not be done;

and the fourth prescribes a preliminary step in the consolidation proceeding.

The stress of the statute is upon the physical conditions under which consolidation may take place, which are stated both affirmatively and negatively. In the first paragraph it is provided that there may be consolidation of the companies whenever their lines of railroad "when completed and connected will form in the whole or in the main one continuous line of railroad" and in the third paragraph authority is in terms withheld to consolidate under other conditions and it is forbidden to consolidate when so doing "will deprive the public of the benefit of competition between said roads."

This third paragraph also provides that any consolidation "contrary to the provisions of this article * * * shall be void."

The article prescribes the conditions of consolidation and also provides a mode. It is not, as this Court has pointed out in Leavenworth County v. C. R. I. & P. Ry. Co., 134 U. S. 688, well arranged. The fourth paragraph should logically be the second and with what stands as second comprehend all the provisions of the statute respecting the mode of consolidation. We would have then a statement of the conditions under which consolidation might be made and the effect of it, the mode in which it was to be done, the conditions under which it was not authorized, and finally the declaration that a consolidation contrary to the provisions of the article should be void.

In the case just cited, the terms of the fourth paragraph of the section, providing that before any railroad companies consolidate their roads they shall file resolutions accepting the provisions of the article, had not been complied with and it was contended that as a consequence the attempted consolidation was void, and that the liabilities incident to consolidation had not been assumed, but Justice Blatchford, speaking for the Court, *l. c.* 698, said:

> "It will be observed that this is the last provision in the statute, though the thing ordered to be done is one of the first steps required in the process. It is also a provision which may well be held to be directory, and designed to secure evidence that each of the companies intending to consolidate recognize the statute as the sole authority for such consolidation, and their obligation to be governed by its provisions. If the other essential provisions of the Act were complied with, it does not necessarily follow that the whole proceeding would be void for failure to comply with this direction of the Act. It is argued, however, that by the express language of the statute it is declared that, 'in case any such railroad companies shall consolidate or attempt to consolidate their roads contrary to the provisions of this Act, such consolidation shall be void, and any person or party aggrieved, whether stockholders or not, may bring action against them in the Circuit Court of any county through which such road may pass, which Court shall have jurisdiction in the case and power to restrain by injunction or otherwise.'

This sentence does not come after but before the provision concerning the resolution accepting the law under which consolidation is made. In the orderly succession of ideas, this concerning the accepting the provisions of the statute was not in the mind of the draftsman when the provision making the consolidation void was penned. On the other hand, the limitation that the companies which are authorized to consolidate are only those whose roads when united 'will form in whole or in the main one continuous line of railroad,' and that this authority 'shall not be construed to authorize the consolidation of any railroad companies or roads, except when by such consolidation a continuous line of road is secured, running in the whole or in the main in the same general direction,' and 'it shall not be lawful for said roads to consolidate in the whole or in part, when by doing so it will deprive the public of the benefit of competition between said roads,' immediately precedes the declaration that any attempt to consolidate contrary to the provisions of this Act shall be void. It is the consolidation of such roads as do not form when so consolidated one continuous line, but may be made up of parallel and competing lines, which is forbidden and declared to be void. The language of the remedy prescribed by the statutes indicates that it is for the violation of this principle that it is given. The Court of the county in which the road lies or through which it passes, not that where the company has its organization or offices, shall have jurisdiction, and the remedy shall be to restrain the company by injunction or otherwise. It is the continuity or par-

allelism of the roads, the benefit of competition by roads between the same points, which is to be secured. And it is clear that the Legislature was not so much interested about the companies and their amalgamation into one company as they were that rival roads and competing roads should not be consolidated and brought under the same control. I doubt very much whether the Legislature intended to declare that even for a violation of this principle, much less of any of the other mere details of the mode of accomplishing this consolidation, it should be absolutely void, void *ab initio*, void anywhere and under all circumstances, but only, as the word 'void' is so often used in legislation and in written agreements, that it should be voidable: that if on investigation the roads were of that character which the statute forbids to be consolidated, the proper Court could so declare and annul and avoid the consolidation."

In the present case the conditions under which consolidation is not only permitted but viewed with manifest favor, all existed. There was a main line and two terminals. They had been operated in conjunction although under separate corporate control. The main line company was insolvent. Stockholders of the three companies and the bondholders as well, desired to unite the three lines and make one of them under one management and one ownership, in other words, consolidate the roads and the companies and to do this, they got together through a committee, and made an agreement, the performance of which accomplished the consolidation of the roads and the companies. The agreement in terms provided:

"That it was 'Necessary for the protection of the interest of the holders of the stocks and bonds' of said companies that they should be 'by means of consolidation or stock control, or in some way, united and legally placed under the practical management, direction and control of one corporate organization, with, if possible, but one class of encumbrance secured upon the whole system and one set of shareholders' " (Rec., p. 821)

A further provision of the agreement was:

"It shall be the special duty of said Committee which they are hereby fully authorized and empowered to perform, to prepare and adopt a plan for the reorganization of the Kansas City, Pittsburg & Gulf Railroad Company, and its property, and also, if necessary, for the reorganization of the Kansas City Suburban Belt Railroad Company, and the Port Arthur Channel & Dock Company and their properties, and for the consolidation of said corporations, if such consolidation can be lawfully made and is found to be practicable, either with or without foreclosure of either or all of said properties, or by means of the acquisition of the stock or other securities, of either or all of said corporations, or in any other manner that may be deemed by said Committee to be most practicable and feasible; and said Committee are authorized to negotiate with bondholders, creditors and stockholders of said companies, or either or all of them, in devising and carrying out said plan, etc." (Rec., p. 823).

The consolidation could lawfully be made, for the requisite physical conditions existed, and it was to be

made in any way deemed by the Committee to be most practicable. Method was of no concern to them, but results were wanted.

And they got the results, and the very results intended by the statute, the unification of the three connecting lines of railroad and one company, and that a new corporation "owning and controlling such continuous line of road, with all the powers, rights, privileges and immunities, and subject to all the obligations and liabilities to the state, **or otherwise**, which belonged to or rested upon either of the companies making such consolidation."

The Supreme Court of Missouri in State ex rel. v. Lesueur, 145 Mo. 322, *l. c.* 328, said:

> "We are of the opinion that the consolidation, when completed in the manner provided, does create a new corporation just as effectually as any other mode allowed by our laws. It will be observed that new stock in a new company issues in lieu of stock in the old companies and a new corporate name is assumed. The new corporation owns all the property, whereas the companies only owned each its own part. The circumstance that the new company remains liable for all the contracts of the old companies does not militate against our conclusion that the statute creates a new corporation but is entirely consistent therewith. By the consolidation the old companies are dissolved and a new corporation formed."

So in the present case we had as a result of the consolidation a new company which assumed a new name

and stock in this new company was issued in lieu of stock in the old companies, and the new company owned all of the property of which the old companies each owned a part.

As to the old companies the Court said in Evans v. Interstate Rapid Transit Ry. Co., 106 Mo. 594, *l. c.* 601:

> "Ordinarily the effect of a consolidation of two or more companies into one is a dissolution of all of them and the creation of a new cmpany. But legal proceedings properly commenced against a corporation are not affected by the expiration of the charter before the determination of such proceedings. Lindell v. Benton & Kennerly, 6 Mo. 361. So where one corporation is consolidated with another while a suit is pending against it, the suit does not abate."

The old companies continue in a perfunctory state of existence for purposes related to the past, but they are dead to the future. A suit against one of the old companies may be continued into judgment or the plaintiff may proceed against the new company. Wells v. Electric Co., 108 Mo. App. 607.

That what was done in this case was a virtual consolidation under the statute results from the fact that it could lawfully be done only under the conditions prescribed and for the purposes designed by the statute. The only authority for what was done is Section 1059 of the Missouri Statutes. One company cannot issue its stock for the entire capital stock of another com-

pany except as a means of consolidation under the conditions prescribed by the statute. It can absorb another company in that way, or in any other, only when the result will be a connected and continuous line of railroad. There was here no sale of the roads by the old companies to the new.

In Barrie v. United Railways Co., 138 Mo. App. 557, the Transit Company was a lessee of the Railways Company. It surrendered its lease and all its property to the United Railways Company, without however making provision for the payment of its liabilities incurred on account of personal injuries, while shareholders of the Transit Company received two shares of Railway stock for each five shares of Transit held by them. There was a very considerable holding in common of the shares of the two companies and the directories were practically identical. The Court held that the transaction under the circumstances was in no sense a sale. It said, *l. c.* 656:

> "Tested then, by universally accepted definitions of the essentials of a sale, this transaction was in no sense a sale. There were not two parties to the transaction. The agent was on both sides of the deal, if it had two sides. There was no meeting of two minds; there was but one mind, one body, a common directorate, controlling, carrying out, even originating the whole transaction; there was no buyer, no seller. All there was in this transaction was the abandonment of the use, of the control, management and possession of the

property by the very same parties under one name, and the taking over of it by the same parties in another name. That is no 'bargain and sale' and does not place the taker in the position of a purchaser."

The facts of the present case are much stronger against the suggestion of bargain and sale. The entire transaction from beginning to end was conducted by the shareholders and bondholders of the old companies with themselves. The only negotiation was between these bondholders and shareholders to determine their respective shares and interests in the deal. This being settled, the Committee representing them, did everything. They organized the new company and issued its bonds and shares to the old bondholders and shareholders, who became *eo instanti* the bondholders and shareholders of the new company. The parties simply, and literally, traded with themselves old bonds and old shares for new. The old companies got nothing. Their bondholders and stockholders got the entire consideration that should have gone to the old companies had the transaction been one of bargain and sale between the old companies and the new. The foreclosure sales which followed were the merest formalities. The new company held the bonds of the old companies and it held their stock, and there was nothing adverse in the foreclosure proceeding. At the end of it all the new company had all the properties and the old companies had nothing. But

the shareholders of the old company were now the shareholders of the new and not by bargain or sale, but by mere transformation.

The transaction being a virtual consolidation the legal consequences follow. Dealing with this phase of the matter the Court in Barrie v. United Railways, *supra*, said, *l. c.* 649:

> "Nor was the transaction under the tripartite agreement intended to assume the form of a consolidation of the two companies. The statute, R. S. 1899, Sec. 1059, expressly provides that on a consolidation of two or more railroad companies, the consolidated body assumes and becomes liable for all of the obligations of each of the constitutive corporations. This general liability which the statute cast on the act of the consolidation was to be avoided, if possible. Our courts have invariably enforced this liability where a consolidation has been effected. They have even treated an act as in law a consolidation, where consolidation was not formally made. Thus a lease by one railroad to another of all its property, for a term of 99 years was held, in Black v. Railroad, 110 Mo. App. 198, to be practically and in law a consolidation and merger of the two companies, its effect being to subject the two roads so consolidated to the liabilities of each.
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> "In Manny v. National Surety Co., 103 Mo. App. 716, this Court held that where one company had absorbed all the assets and assumed all the liabilities of another, the act was to be treated as a con-

solidation, and the absorbing company held liable on a bond given by the one absorbed. In this Manny case, however, there was an express assumption of all liabilities by contract."

A number of Missouri adjudications are cited by the Court to sustain its view. The Barrie case was decided by the Court of Appeals, not the Court of last resort in Missouri, but it has the sanction of our highest tribunal, for in Johnson v. United Railways Company, 247 Mo. 326, where the same transactions were involved, the Court put the question, "Was Barrie v. Railroad Co., 138 Mo. App. 557, well ruled"? and answered, "We hold it was and adopt the opinion in that case, its statement of fact, its conclusions of law and its reasoning bodily as our own."

In Illinois there was a statute authorizing the consolidation of connecting companies and another authorizing one company to purchase the road of another provided the lines were not competing. In the case of C. S. F. & C. Ry. Co. v. Ashling, 160 Ill. 373, the question was whether the transaction involved was a consolidation or a sale. The notices of intended action and the proceedings of the corporation were more in conformity with the statute providing for purchase and sale than with that providing for consolidation. But the Court said, page 380, "We must look to the results accomplished rather than to means, steps or procedure by which those results have been attained." In fact the St. Louis Company conveyed its property

by deed to the Santa Fe Company in consideration of one dollar paid to the St. Louis Company and the assumption by the Santa Fe Company's of the St. Louis Company's bonded debt and the issuance by the Santa Fe Company of its stock dollar for dollar to the shareholders of the St. Louis Company in exchange for their stock. The Court said, *l. c.* 380:

> "The resolutions and deed of conveyance provided that, in addition to the consideration of one dollar, to be paid by the Santa Fe Company, and the assumption and payment of the bonded indebtedness of the St. Louis Company, the Santa Fe Company should issue its stock to the stockholders of the St. Louis Company, dollar for dollar, in exchange for their stock in the latter company. The effect of this part of the transaction was to incorporate in the Santa Fe Company the stockholders of the St. Louis Company, combining all the stockholders of each company in one. This was an act of consolidation, and not by any means necessary to a mere purchase and sale. If the transaction could be distinguished from a consolidation as a mere purchase and sale, to be regarded as a fair one (and it should be so regarded for the purpose of the argument), the St. Louis Company itself, and not its individual stockholders, should have received all the consideration for the property conveyed, so that it would have the equivalent of the property sold with which to meet the obligations and liabilities which it had created or incurred. True, this is not a creditors' bill to reach assets improperly diverted, or to set

aside an alleged fraudulent sale, and no question is raised as to the good faith of the transaction, but we must consider all the elements of the transaction in order to determine whether there was a consolidation or not. By the transaction, the St. Louis Company was left without property, corporate rights, or franchises of any kind, and without stockholders. All of these were transferred bodily to the Santa Fe Company, and became united, respectively, with the property, rights, franchises, and stockholders of the latter company. Why was this not a consolidation of the St. Louis Company with the Santa Fe Company? There is no magic in words. Merely calling the transaction a purchase and sale would not prevent it from being a consolidation. It cannot be supposed, from the nature of this transaction, that it was expected that the St. Louis Company should continue its active corporate existence after divesting itself of all its property, corporate rights and franchises, and stockholders."

In Shadford v. Detroit, Etc., Ry. Co., 130 Mich. 300, a street railway company was organized to acquire the business and property of all other street railway companies and this was accomplished by issuing the stocks and bonds of the new company to the stockholders and bondholders of the old companies in exchange for their old stocks and bonds, the old companies getting nothing for their properties. This it was held was a consolidation and not a sale even though the statutes did not authorize a consolidation. The Court said:

"It is urged that the acts under which these companies were organized do not authorize a consolidation, and therefore any attempted consolidation would be illegal and void. In this case the conclusion applied to this proposition is that the defendant is not in position to raise the question if there was **in fact** a consolidation between the Ann Arbor Street Railway Company and Ann Arbor & Ypsilanti Street Railway Company, and the Ann Arbor & Ypsilanti Electric Railway Co., and between the last company and the defendant the latter cannot deny its liabilities. * * * The legality of its **organization cannot be attacked collaterally in suits by and against it, based upon dealings with it.** * * * So long as the State chooses to recognize its validity by keeping silence, it is a corporation *de facto*, although not *de jure*, and liable the same as any other corporation in its dealings with others. * * * Did the transaction between these companies constitute **consolidations or sales?** * * * The **stockholders**, managers and directors of the old companies were the parties **who created and organized** the Electric Company and who **transferred all the stock to the new company**. The directors of the two old companies all become stockholders in the new, and most of them, as well, bondholders. The Electric Company paid not a dollar to the other companies as compensation for the transfers of all the properties to it. **The arrangement left the two old companies without assets and without business.** They were virtually out of existence by the arrangement. * * * Under defendant's contention their cred-

itors had no remedy except by suit in equity to compel the stockholders to pay assessments to the full value of their stock, or to reach the stock and bonds of the Electric Company which had been received by the stockholders of the old companies upon the theory that they were assets of those companies. * * * We think that **the law will not permit such a transaction upon the theory of a sale.** * * * The law will not permit the creditors of two corporations to be deprived of the assets of such corporation in payment of their debts and turn them over to suits in equity against the stockholders when the union or consolidation of another corporation is effected without the passage of a dollar or other valuable consideration between the corporations themselves."

As there was not in the case at bar a sale by the old companies of their railroads to the new company, there was a merger or consolidation, through which the new company acquired the properties of the old, the stockholders of the old companies reserving to themselves all their interests and becoming in due proportion stockholders of the new corporation, and the legality of this consolidation may not be denied by the corporation which owes to it its existence and has derived from it all its property and powers and neither may it disclaim the consequences which the statute authorizing the consolidation imposes upon it, which are that along with "all the powers, rights, privileges and immunities" of the old companies it must accept "all

the obligations and liabilities to the State or otherwise" which rested upon either of them.

XII.

Suggested Equitable Terms of Recovery.

The Southern Company delayed the Trust Company in the establishment of its claim for ten years by what we have the warrant of the Court of Appeals for characterizing as vexatious and harassing litigation. Nor did it stop with that. Appeals to the Circuit Court of Appeals and appeals from that Court have added five years more to the delay. During all these fifteen years there has never been the proffer of a dollar, but always a denial and contest of any liability whatsoever. And now, if at the end of the litigation, the liability is confirmed by the Court of last resort, the Court is asked not to enforce payment, but to make adjustment and "prescribe such equitable terms as should have been offered at the time of the reorganization if the Trust Company's claim had been liquidated." The accumulation of interest during the delay has doubled the amount that is due, and this makes it more inconvenient than ever to do complete justice. So it is proposed to eliminate the interest which the law allows to a delayed creditor and substitute for it something in the nature of discount to the reluctant debtor. The concrete suggestion is that the Trust Company shall be paid the face of its claim in preferred stock of the Southern Company at par as of the date of the re-

organization. This with the dividends paid and interest on the dividends would come to three hundred thousand dollars or more dependent upon the time chosen for ascertaining the market value of the stock, but in any case the amount suggested is less than half of what is due.

But the plan of reorganization did not liquidate the debts in preferred stock. It paid them in cash. Every other creditor was so paid and paid at the time. And the Trust Company is entitled to be so paid.

Moreover, the shareholders of the Belt Company received for their shares one-fourth of the par in preferred stock and three-fourths in common and every creditor was entitled to priority as against them. But aside from this, there was an ample reserve fund at the time of the reorganization to pay all creditors in full and upon that reserve the Trust Company relied to be paid as all other creditors were paid.

It is not a principle of chancery jurisprudence that wilful delay is tantamount to partial performance, and that the rights of the Trust Company have been denied and contested for fifteen years, is not an equitable reason for limiting its redress to less than half its just measure.

XIII.

The Lands of the Central Improvement Company did not pass under the after-acquired property clause of the Belt mortgage.

The Central Improvement Company was a corporation with an authorized capital stock of $200,000, di-

vided into 2,000 shares. Of this 1,407 shares were issued and outstanding, and of this 1,120 shares which had belonged to the Belt Company were in July, 1899, pledged by the Belt Company to the Trust Company as collateral security for the Belt's debts. The property of the Central Improvement Company consisted entirely of land. The final decree of the Circuit Court was that the shares of stock pledged by the Belt Company to the Trust Company should be by the Trust Company subjected to the payment of the Belt's debt; but the decree also provided that all of the property of the Central Company now held by it should be conveyed to the Southern Company. Thus the kernel of the nut was awarded to the Southern Company and the shell was awarded to the Trust Company.

The Central Company was organized for the purpose of holding lands which were acquired in connection with the railroad enterprise but which were not intended by the companies to come under the mortgages of the defendant railroads. These were lands either bought or leased for the purpose of erecting for the railroads or for some vendee, industrial plants with the view to increasing the traffic of the roads; or lands acquired for the use of terminal yards for switching, in view of both present and future necessity, or lands purchased in part for providing the right-of-way where the entire tract was bought for about the same price as the right-of-way would cost, and after carving out the right-of-way the surplus was conveyed to and held by the Central Improvement Company.

Some lands of this character had been acquired by a predecessor of the Central Company known as the State Realty Company which sold them to the Central Company at their actual cost, and the stock of the State Realty Company (which was held by the railroads) was exchanged for stock in the Central Improvement Company. Thereafter the Central Company made the purchases and acquired the lands itself. In the case of each particular tract of land, the custom of conducting the business was that the Central Company would make requisition on the railroad company adjacent to the land thus to be acquired, for the necessary funds to pay for the land to be purchased, and this railroad company would then issue to the Central Company its voucher to cover the price and the expenses incident to the purchase. The Central Company would then issue to this railroad company its stock in an amount of even hundreds of dollars of par value closest to the sum thus advanced by the railroad company, and to make that amount even, in hundreds of dollars of par value, either the Central Company would issue its voucher for the remainder in excess of the even hundred of dollars or would issue to the railroad company stock up to the necessary hundred of dollars and collect from it the difference between the amount of stock so issued and the additional amount paid in by the company on the purchase in question.

Taxes, insurance and other fixed charges accruing

after the time the land was taken by the Central Company were paid out of the funds in the Central Company's treasury and charged to profit and loss. The financial resources of the Central Company were derived from the moneys contributed by the railroads to purchase the land, and also derived from the rents and sales of buildings on the property purchased by it. This income was disbursed for general purposes and applied to the payment of expenses of all the real estate without any discrimination whatever; that is to say, rents received from the property originally purchased with funds of the Belt would be applied to the payment of taxes or other expenses on the property acquired by the funds of the Pittsburg & Gulf Company, and vice versa. The Central Improvement Company also borrowed money on one tract of the land securing it by mortgage. Upon its maturity this mortgage was purchased by the Southern Company and is now held by it and stands unreleased on record.

Upon all of these facts, it was and is contended by the receiver of the Central Company and by the Trust Company for him, that the lands of the Central Improvement Company did not fall within the terms of the after-acquired property clause of the Belt mortgage, and that the decree of the Circuit Court was erroneous in directing the conveyance of these lands to the Southern Company.

The facts of this case are almost identical with the Wabash Elevator case, Humphreys v. McKissock, 140

U. S. 304. The Wabash, with other roads, subscribed to the capital stock of the elevator company which, with the proceeds of the stock subscribed, constructed an elevator near the tracks of the various roads for the sole purpose of handling grain to be transported over the roads. In a contest between the receivers of the Wabash, appointed generally, and a receiver of the Wabash property described in the foreclosure proceeding, it was contended that the Wabash Company possessed a separate interest in the property of the elevator corporation, but this Court held that the elevator company was of independent existence and the railroad company had no personal interest in the elevator company's property which it could mortgage and that the railroad company was a mere stockholder in the elevator company. The Master seeks to distinguish between that case and the one at bar on the ground that the record in the present case shows that the specific properties desired by each road were paid for by each company, while in the Wabash case there were undivided interests. But such a distinction is not authorized by the decision in the elevator case and is furthermore in conflict with the fact found by the Master that in the conduct of the affairs of the Central Company after the purchase of its different lands the expense of maintenance was paid out of the treasury of the company and that the income of the company derived from rents and sales of the property went into the common treasury and was disbursed for different

purposes and applied to the expense of all the real estate without discrimination.

Furthermore, by the great weight of authority it is competent for a railroad company to purchase lands and hold them free of the lien of the after-acquired purchase clause of the mortgage when they are purchased under the circumstances and for the purpose and with the intention which prevailed in the present case. Pardee v. Aldridge, 189 U. S. 429; Smith v. McCullough, 104 U. S. 25; Railroad v. Coffin, 50 Conn. 150; Densmore v. Railroad, 12 Wis. 649.

The facts that the Belt never made claim to the Central properties, although the first of them was bought in 1895; that neither the Southern Company nor the Reorganization Committee made claim to these properties until February 27, 1905, when the intervening petition was filed; that the Southern Company bought and holds, so far as the record discloses, a mortgage executed by the Central Company conveying one of the properties in question—all point to the conclusion, which the Court should have drawn upon the facts found by the Master, that the Southern Company was barred by its laches and especially by its acts from the assertion that the properties of the Central Company were included within the lien of the after-acquired property clause of the Southern's mortgages.

XIV.

Even though the exception to the Master's report did not formally and directly challenge the correctness of his finding, which was one of law, that the Southern Company was not liable for the indebtedness of the Belt Company, none the less in the circumstances of the case it was competent and proper to consider and determine the question upon its merits.

The exceptions to the report of the Master finding the Southern Company not liable for the indebtedness of the Belt were framed in the view that there should have been no finding upon that issue, because,

a. The Master found that the intervening petition of the Southern Company was not maintainable by reason of laches.

b. The finding was unnecessary to the determination of the case upon the facts found by him and so the incorporation of the finding in the decree would be unnecessary and immaterial.

c. No relief was asked against the Southern Company and the other defenses of the Trust Company to the petition of intervention had been found to be valid.

d. In the injunction proceeding of the Southern Company against the Trust Company to enjoin the suits at law in the State courts, the Circuit Court of Appeals had decided that the personal liability of the Southern Company was not in issue in this suit, saying: "The liabiilty of the Southern Company to pay the debts which the Trust Company alleges in the ac-

tion at law it has promised to pay, is not in issue and cannot be determined in the suit in equity, and the State court has no jurisdiction over and cannot interfere in those actions in personam with the specific property which is the subject of litigation in the Federal Court " (171 Fed., *l. c.* 50).

e. Under the law and the evidence as reported by the Master, requiring the dismissal of the original Cambria bill, the Southern Company was not entitled to relief under its intervening petition and that petition should have been dismissed (Rec., p. 894).

Counsel for the Trust Company were evidently of opinion that the question of the personal liability of the Southern Company for the Belt debts was not involved in the litigation inaugurated by the Cambria Company.

The bill of the Cambria Company, the ancillary bills of the Belt Company and its receivers, and the intervening petitions of the Southern Company, denied any indebtedness on the part of the Belt to the Trust Company, asserted on the other hand a large indebtedness on the part of the Trust Company to the Belt and sought as a remedy a judgment in behalf of the Belt against the Trust Company and a release by the Trust Company of the Belt collateral.

As against this the Trust Company asserted its claims against the Belt Company and its right to the Belt collateral and as a remedy sought a judgment against the Belt Company and a dismissal of the injunctions which forbade its sale of the collateral. It

did allege the personal liability of the Southern Company, but not as a ground of affirmative relief.

For affirmative relief it had brought its suits in the State courts. By supplemental bill in the Circuit Court the Southern Company enjoined the suits in the State courts. In this proceeding the Southern Company insisted that the issues presented by the Trust Company in the State court cases were involved in the present, the Cambria suit, the contention and the argument upon it being thus stated by the Court of Appeals:

> "That the indebtedness of the Belt Company to the Trust Company, and the cancellation of the notes which evidence a part of that alleged debt which the Trust Company claims was assumed by the Southern Company, are at issue, and will be ultimately determined upon the accounting in the equity suit, and they argue that if those issues should be determined against the Trust Company in that suit there would be no basis for the alleged assumption of a debt of the Belt Company by the Southern Company, or for any judgments against them."
>
> (Guardian Trust Co. v. K. C. Southern Ry. Co., 171 Fed. Rep *l. c.* 46.)

And to this the Court answered (*l. c.* 50):

> "The liability of the Southern Company to pay the debts which the Trust Company alleges in the actions at law it has promised to pay, is not in issue and cannot be determined in the suit in

> equity, and the state court has no jurisdiction over and cannot interfere in those actions in personam with the specific property which is the subject of litigation in the federal court."

Counsel for the Trust Company thought this settled the matter and framed the exception to the Master's finding accordingly.

It is obvious, however that the Trust Company did not yield its contention as to the Southern Company's liability. Counsel had asserted it elaborately in all their answers in the Federal Court and by the suits in the State Court. Had they intended to acquiesce in the Master's findings they would not have excepted at all. But they did except and very elaborately but upon what the Circuit Court of Appeals later determined was too narrow a ground.

When the pending suit came before the Court of Appeals, counsel for the Southern Company, arguing that the exception was insufficient and that the Trust Company should therefore be turned away without redress, said:

> "The decision of the question of the Southern Company's liability for the debts of the Belt Company was necessary to a disposition of the case. The defense pleaded by the Trust Company to the effect that the Southern Company had assumed or become liable for the indebtedness of the Belt Company was, if true, a perfect answer to the intervening petition. It said in substance to the Southern Company—'Even though you

may have the legal or equitable title to the collateral securities or to the properties represented by them, yet they were pledged by the Belt Company to secure its indebtedness, you assumed and agreed to pay that indebtedness and a court of equity will not award you possession of the securities until you discharge your own obligation. Any relief to you must be conditioned upon your payment of the Belt Company's indebtedness' " (201 Fed. Rep. *l. c.* 817).

As to the formal insufficiency of the exception the Court agreed with counsel and said with respect to their opinion in the injunction suit:

"This contention that if the Southern Company had become liable for the indebtedness of the Belt Company to the Trust Company that was a perfect defense to the intervening petition of the Southern Company is sound and unanswerable, and after a careful review of the record in this case this court holds, and it decides, that the issue whether or not the Southern Company was indebted to the Trust Company for the debt of the Belt Company to the Trust Company was a material and decisive issue between the Trust Company and the Southern Company in this case which it was the duty of the Master and the Court below to consider and decide. The remarks of this Court in **Guardian Trust Co. v. Kansas City Southern Ry. Co.**, 171 Fed. 43, 96 C. C. A. 285 that 'The liability of the Southern Company to pay the debts which the Trust Company alleges in the actions at law it has promised to pay is

not an issue and cannot be determined in this suit in equity,' upon which counsel rely, must be construed, as must all opinions of the Courts, in the light of the facts and the issues then in hand. The issue before the Court in that case was whether the causes of action in the State Court were so identical with the cause of action theretofore pending in the Court below that an injunction should be issued to stay the prosecution of the actions in the State Court. This Court held that the suit in the Circuit Court was in equity, that it related to the title and ownership and the right to a conveyance of certain specific property, while the actions at law brought by the Trust Company against the Southern Company in the State Court where purely **in personam** to recover the alleged debts of the Southern Company, that in the suit in equity the same relief was not sought as in the actions at law and that the prosecutions of the actions at law in the State Court constituted no interference with the suit in the Court below. There was nothing in the decision in that case in conflict with the conclusion which has now been reached'' (201 Fed. Rep. *l. c.* 818).

The Court did not agree, however, that for a technical inaccuracy of this sort, the Trust Company was to lose its case altogether, if it was a just one and that appeared as matter of law upon the face of the Master's report. There was an exception to the finding and there could be no question but that counsel deemed the finding to be contrary to the right of the case.

A question is raised as to how the reference to the master was made, appellant insisting that the Court of Appeals was in error in saying that upon the issues before it the reference had been made by the Court upon its own motion. Brief, p. 185. On p. 183 it is said that "there is nothing in the record to indicate that the issues made" on the first intervening petition were referred to the master, and on p. 185 that there was no reference made on the filing of the ancillary bill of the Belt Company and its receivers.

All this is in direct contravention of the record. The statement of the Court of Appeals is not "wholly erroneous," but entirely correct. After the ancillary bill had been filed and answered and some exceptions to the answer had been sustained it was ordered by the Court that "the cause shall stand referred to Shannon C. Douglas as special master to take the proofs and report the same, with his conclusion thereon to this Court, in connection with the issues in the original cause herein, and matters heretofore referred to him in the original suit herein, at the earliest practical date" (Rec., 161).

This referred the entire case and it was done by the Court upon its motion.

In the order granting leave to the Southern Company to file its petition of intervention and providing for answer thereto, the Court further ordered "that the issues so made shall stand referred to Honorable Shannon C. Douglas, Special Master, to take

the testimony thereon and make report with all convenient speed" (Rec., 166).

And again when leave was given to the Belt Company and its receivers to file the amended and supplemental ancillary bill of complaint the Court on its own motion ordered that it "stand referred to, etc., etc.," (Rec., p. 266).

The only consent to a reference was on the filing of the amended intervening petition of the Southern Company, (Rec., 267), and as to this the Court of Appeals said correctly that "the stipulation that the new issue made by the amended intervening petition should be referred to the Master was a stipulation made with reference to that issue; that issue was decided by the master in favor of the Trust Company, and is not before us for review" (201 Fed. Rep. 825).

So the Trust Company is not limited in its right of review by any consent given to the reference to the master.

But even if the reference had been by consent, the findings of the Master as to matters of law were subject to review even though the exceptions to them were defective in form.

An exception is not the source of a right. The purpose of exception is to promote the convenience and dispatch of judicial business. The case having been referred to a Master and reported back to the Court, the parties are required to make their objections to the report, to point out what they complain of as

wrong, and so bring the contention before the Court within the narrowest compass reasonably possible. Exceptions serve the same purpose as assignments of error on appeal. They are both aids to the Court and neither of them pitfalls for litigants. Wilful neglect of or wanton indifference to their reasonable requirements may well forfeit the right to be heard, but when there has been an earnest and diligent striving to comply with the rules, when the divergence from the prescribed course is but slight, and the result, to say the very most, of a mistake, easily made, as to what is the prescribed course, all hope of redress is not cut off. It is the rule of this Court, notwithstanding its requirements of specifications of error, "that the Court at its option may notice a plain error not assigned or specified." And such is the rule of the Court of Appeals of the Eighth Circuit and of appellate tribunals generally.

Exceptions to a Master's report are in the nature of assignments of error. Here we have a case triable *de novo*, presenting not a question of fact, but one of law, involving the merits of the controversy, where the contention of the party throughout has been against the Master's finding, where the exception as made plainly indicates that he is still against it and believes it to be wrong, and the exception if technically perfect could do no more than this, and the Court is asked to strip the suitor of the redress gained after fifteen years of stubborn litigation and turn him helpless and hopeless away from its bar.

The general rule undoubtedly is that what is not excepted to in the Master's report will not be reviewed by the Court, but it is also undoubted "that if the report of the Master is clearly erroneous in any particular, it is within the discretion of the Court to correct this error" Sheffield Railway Co. v. Cordon, 151 U. S. 285, *l. c.* 291. Counsel for the Southern cite 17 Enc. Pl. and Prac. 1047 as containing the best statement of the general rule, but the very next paragraph to that which they quote informs us that "in some jurisdictions, however, errors which appear on the face of the report may be taken advantage of without exceptions. And it has been held that where the Master by his report states the facts correctly, but errs as to the legal conclusions, the party against whom he errs is not required to except to the report, but may bring the question to the attention of the Court upon further directions" (17 Enc. Pl. and Prac. 1048).

Daniel in his Chancery Pl. and Prac., 2nd Vol. 1314, states that "there are cases in which, under particular circumstances, it (the Court) will relax its rules and permit exceptions to be filed after the report has been absolutely confirmed."

In Himely v. Rose, 5 Cranch, 313, it was decided that it is not necessary to take exception to the report of auditors, if the errors appear upon the face of the report.

The general rule with its qualification as stated by Daniel is approved by the Court of Appeals of the

Seventh Circuit in Burke v. Davis, 81 Fed. 907, *l. c.* 910, where it is said:

> "In the absence of exceptions to the report, there can be no inquiry into the correctness of the Master's findings of fact; but whether the proper decree was entered upon the report is nevertheless open to consideration. The Master's mistaken apprehension of the legal consequences of the facts reported, as Daniel states it, 'may be opened to further directions, without exceptions' 2 Daniel Ch. Prac. p. 1310; Hayes v. Hammond, 162 Ill. 133, 44 N. E. 422."

Wallace, J. in Celluloid Mfg. Co. v. Cellulite Mfg. Co. 40 Fed. 476, *l. c.* 477, says that the general rule "does not preclude the defendant from being heard upon a question of the correctness of the legal conclusion reached by the Master."

Mr. Justice Story in Gordon v. Lewis, 2 Summer, 143, says:

> "Whatever may have been insisted upon before the Master by way of argument or objection, is considered as waived or abandoned, if it is not made matter of exception, unless, indeed, it manifestly appears upon the face of the report itself, that the Master has committed an error, which ought to be corrected."

Other cases recognizing the qualification of the general rule, are:

Brooks v. Robinson, 54 Miss. 272;

Haymond v. Murphy, 65 W. Va. 616;

Webster v. Cadwallader, 133 Ky. 500;
Lehmann v. Powe, 95 Miss. 446;
Von Phalen v. Winterbotham, 203 Ill. 202.

The liability of the Southern Company for the indebtedness of the Belt Company is asserted in six elaborate pleadings filed in this suit and in two suits instituted by the Trust Company in the State Court, and we submit that it should not be held to have been waived, abandoned or lost, upon mere hairsplitting considerations as to the formal sufficiency of an exception to a Master's report, especially so, where the form of the exception was determined by what counsel conceived to be the scope and effect of a previous ruling of the Court made in the same case and with relation to the same subject.

The suggestion of hardship upon the other side is wholly without force. The parties complainant, the Cambria Company, the Belt Company and the Southern Company, did not and could not believe that the Trust Company had waived the claims of liability upon which the value of its judgment against the Belt Company so largely depended. They had no right to speculate upon the possibility that the Trust Company had erred in a mere matter of procedure, and then insist that the error, however trivial, was irremediable because they had speculated upon it. A gambling hazard does not commend itself to a Court of justice.

More than this, why should a decision favorable to the Southern Company upon the question of liability

induce that company, or the Cambria or the Belt, not to appeal the judgment against the Belt Company. They had all contended that the Trust Company was heavily indebted to the Belt and they were, each of the three, interested to recover the amount of that indebtedness. Besides, even though the Trust Company was not indebted to the Belt, they were interested none the less to prevent any judgment for the Trust Company against the Belt, because the Trust Company held as collateral, certain assets of the Belt which it must give up if its claims against the Belt were invalid. So there was and could be but one reason for not appealing from the judgment against the Belt and that was that there was no question of its propriety.

In truth, as the Court of Appeals said, the Cambria suit was not in good faith, but that company and the Belt were used simply as aids to the Southern in its contest against liability for Belt indebtedness. The Cambria had two strings to its bow. The Southern Company was liable to it beyond a preadventure. It was not estopped from asserting that liability for it had not shared in the plan of reorganization. The Trust Company could be liable to it only through indebtedness to the Belt Company. The question of liability of the Trust Company was one of fact and when the fact was ascertained the liability did not exist. The liability of the Southern Company, one of law upon conceded facts was never asserted by Cambria, although it was asserted for ten years by the Trust Company in Cambria's own suit. Cambria simply made

common cause with the Southern against the Trust Company. They began proceedings against it on the same day, the 6th of September, 1900 and they ceased their aggressions on the same day, ten years thereafter, the day when the judgment for the Trust Company, a barren one as they hoped, was entered.

XV.

There is no reason of law, policy or morals for preferring stockholders to general creditors in the reorganization of railroad properties.

The petition for certiorari like the brief on the appeal states that we base our case on "the alleged fraudulent character of the re-organization plan." This, as we have shown, is a misstatement of our position.

The petition further states that this is in the face of four conceded facts, when in truth the alleged facts are either not conceded at all or conceded only with such qualifications as entirely change their significance.

And many vital and fundamental questions it is said should be answered in order that protracted litigation in other cases may be avoided.

These questions, as put by petitioner, are:

> (a) "May a security holder exchange his securities under a plan of reorganization, and having done so, may he afterwards, notwithstanding the doctrine of estoppel, election and ratification, and without making restoration, recover from the new company for the debts of the old one, for the sole

reason that stockholders are given an interest in the new company?''

If the doctrine of estoppel, election and ratification is involved, of course, it may not be ignored. We say there was no estoppel and no requirement to elect.

(b) ''Is it competent for a security holder who accepts the plan and exchanges his old securities for new ones to enter into a valid covenant to waive the assertion of any and all other claims against the new company by reason of his dealings with the old company.''

Such a covenant undoubtedly might be made upon a good consideration, but no such covenant was made.

(c) ''If a court shall hold, in some subsequent proceeding, that the terms offered to a non-assenting creditor fell short of being ''equitable,'' will the court prescribe and enforce terms which it finds should have been offered, or will the creditor be entitled to enforce a money judgment against the new company for the face of his claim and accumulated interest? Can the reorganization committee invoke the judgment of some court to determine what will constitute 'fair terms' or must it act at its peril?''

No question as to a non-assenting creditor is here involved. We assented to a plan under which all other debts were paid and that provided for the payment of the debt to us, and we ask only that we be dealt with as all other creditors were and according to the promise. It is too late now to rescind the plan and to ask the Court to formulate a new one.

(d) "If the existence of a creditor be unknown at the time and he subsequently appears and brings suit against the new company, or if his debt is disputed at the time, but is afterwards established, will the court permit the new company to offer the creditor such equitable terms as would have constituted a 'fair offer' at the time of the reorganization, or shall his debt and accumlated interest be paid."

The existence of the creditor here in question was known, and his rights cannot be impaired by the fact that he was hindered and delayed for fifteen years in establishing the validity of that debt. A "fair offer" in this case would be what was offered to every other creditor.

(e) "May a bondholder decline to come into a reorganization in which stockholders receive any benefit, accept his distributive share of the proceeds of the foreclosure sale, credit the same upon his bond and recover the balance against the new company, realizing both principal and interest in full, thus making it impossible to induce bondholders to come into any reorganization?"

This is a moot question. There is no such bondholder before the Court.

(f) "What rule is to govern the 'issuance on equitable terms, of income bonds or preferred stock' to non-assenting creditors? Should preferred stock or income bonds at par equal the face of the creditor's debt? If not, how should the pro-

portion or ratio of stock or bonds to debt, as well as the relative value of securities and debt, be determined?"

Also a moot question. There was no preferred stock or income bonds issued or proposed to be issued on equitable or inequitable terms to non-assenting creditors. The Trust Company is now the only creditor in the case and asks only that it be paid as the plan promised and as other creditors were paid.

(g) "If stockholders are assessed as a condition to participation in the plan, may creditors also be assessed in a similar manner as a condition to the issuance to them of income bonds or preferred stock? Will creditors be denied relief, as stockholders are, if they fail to pay their assessment?"

A moot question. Nobody was assessed in the Belt case. The bondholders got new bonds and stock. The stockholders got new stock in equal amount and 25 per cent of it preferred. The creditors were all paid, save the Trust Company. How is the question put by petitioner involved in these facts?

(h) "If in an 'adversary proceeding' it is determined that the valid mortgage indebtedness of the debtor equals or exceeds the fair value of the debtor's property so that there is, in fact, no equity out of which the debt can be satisfied, will the new company, nevertheless, be required to satisfy the debt if it issues its stock in exchange for the stock of the old company?"

Also a moot question. There was no such adversary proceeding and on the contrary an agreement by all the bondholders and stockholders that the Belt properties had a value sufficient to justify the issue of new bonds to take up the old bonds against it, to pay all the debts of the old company and in addition sustain an issue of valid full paid and non-assessable stock of the new company to the extent of $4,750,000.

That there are now five railway companies in the hands of receivers in the Eighth Circuit may be true, but this Court will not enter into a conference with financiers to determine how best the stockholders of these companies can be served at the expense of creditors.

Friends of the Court have gathered to this case in great numbers, but not as friends of the unsecured creditors. And the purpose of these friends is to have it determined that to be unsecured is to be insecure and without protection whatever.

The Santa Fe friends say that there has been brought against them by an income bondholder an ill-founded and twenty years' belated suit to which "we do not regard the decision of the Circuit Court of Appeals in the above entitled cases (the cases at bar) as at all applicable." Then why burden this case with an irrelevant intervention? Is it simply to emphasize the fact that the unsecured creditor is the outlaw of railroad finance, whom it is lawful for anyone to despoil.

The Frisco people are here and say that they con-

template reorganization and so desire a deliverance from the Court "for the protection of those purchasing railroad securities" but they say nothing as to protection of the unsecured creditor.

The Orient Company also contemplates reorganization and with commendable candor tells the Court that "unless the stockholders can be invited to participate in a reorganization, based on the purchase of new securities for additional money, **without having the reorganized company thereby assume payment of the debts of the old company, the reorganization will necessarily result in eliminating the stockholders. It is of the utmost importance to the interests of the stockholders that before any such plan is promulgated, the law on this subject shall be definitely settled.**"

But this company has not one word to say in behalf of its general creditors who are prior in right to those stockholders. The appeal to the Court is to ascertain how the unsecured creditor may securely be eliminated.

The Wabash Pittsburgh Terminal Railway Company is even more blunt in the statement of what it wants, and says that "it is important that there be no doubt as to the legality of the reorganization or as to the validity of the securities which the reorganized company will issue, **and that the creditors of the present companies shall not be permitted to assert their claims against the new company.**"

There is no friend of the Court appearing either for the general creditor or for the general public. These

interests must protect themselves. What is sought is a way of reorganizing railroad companies which will secure something of value to the stockholders while leaving general creditors unpaid, something that is based upon nothing when a creditor asserts his claim, but based upon solid values when the public is concerned in respect of rates and charges. Reorganization by elimination of general creditors, and this done legally and honestly, is the great desideratum. They invoke the morality of Sam Slick, the clock maker of Slickville, Connecticut, as he preached it to his townsman, Expected Thorne, whom on one of his rounds of clock selling he found indicted for stealing a watch. "You hadn't ought to have stolen that watch. That was wrong, very wrong, indeed. You might have traded with him and got it for half nothin' or bought it and failed; or swapped it and forgot to give the exchange; or bought it and give your note, and cut stick afore the note became due. There's a thousand ways of doing it honestly and legally, without resortin' to stealin'."—Haliburton's Sayings and Doings of Sam Slick, the Clock Maker.

Modern finance has discovered an element in railroad property which it holds to be of great value, but which it proposes to make valuable exclusively to the stockholder, and in which the unsecured creditor can have no part. The property mortgaged is not worth as it stands the mortgage indebtedness, and so, of course, the unsecured debts are worth nothing. But it has a

capability of being reorganized into great value and this capability may be made the consideration of the issue of new stocks which will control the railroad as reorganized and serve as the basis of future if not of immediate dividends. But such is the nature of this capability that it neither can nor should be made the means of paying unsecured debts.

The Boyd case stands in the way of this, for there the Court decided that if there was a value in the property, evidenced by a substantial issue of securities, even though realized through reorganization, that value belonged to the creditors rather than to the stockholders. It was not something purely metaphysical when creditors were concerned and substantial as to stockholders, something which they could list and buy and sell on the stock market. Neither was it something purely sentimental, a brotherly feeling on the part of the bondholders, impelling them to give to the stockholders a substantial interest in property which was not worth the amount of the bonded debt. The bondholders might foreclose strictly and securing it in this way, fairly and openly, they could do with it what they pleased, give away part of it or all of it. But if they reorganized, whether without foreclosure, or with formal foreclosure as an incident of their plan, and provided from the beginning for the realization of value in the reorganized property by the stockholders to the exclusion of the unsecured creditors, then there was a taking from the creditors of what belonged to them and giving it to the stockholders.

The case of the Trust Company is supported not only by the majority opinion in the Boyd case, but by the minority opinion as well. Here are none of the elements of laches which Mr. Justice Lurton held should bar the claim of Boyd. The fundamental principle was asserted by the minority as well as by the majority. "That corporate property must be applied to corporate debts before shareholders can participate is plain," 228 U. S. *l. c.* 511. And there was not here, so far as concerned the Belt Company, the financial difficulties that beset the reorganization in the Boyd case. No assessment was made upon either the bondholders or the stockholders of the Belt and no foreclosure sale was necessary to carry out the plan. The foreclosure had was the merest formality and what was accomplished by it, could as well have been done by a quit claim deed from the Belt to the Southern.

The bondholders of the Belt dealt handsomely with themselves. They not only took Southern bonds in exchange for their old bonds, but in addition a premium in bonds of thirty-three per cent and a second premium in preferred stock of twenty-five per cent.

Nor did the stockholders of the Belt neglect themselves. They took new stock for old, par for par, and of the new stock twenty-five per cent was preferred. The appropriation of this stock to themselves, if it be true that they designed to leave creditors unpaid, was a violation of the principle announced by the minority as a plain one, "that corporate property must be ap-

plied to corporate debts before shareholders can participate."

Why is there such a persistent and concerted effort to strike down the rights of general creditors in these "reorganizations"? Their claims are as meritorious as those of stockholders and in law and equity stand above them. The reason is simply that usually these creditors while considerable in number are entirely unrelated and so not easily brought to act in concert, and individually the claim is not large enough to justify the expense of litigation. And to a great extent they are made up of personal injury claimants and so looked upon with special disfavor by the reorganizers. Sometimes, as here, a larger interest is involved, and then there is recognition or a contest.

Stockholders and bondholders naturally act in concert. The same persons are usually holders of stocks and of bonds, or in any event there is a community of interest and a class consciousness to bring them together and they operate like the upper and the nether mill stone and grind whatever comes between.

The Court of Appeals in the present case has not extended the doctrine of the Boyd case and had no occasion to do so. They did not as was done in the Boyd case, condemn the plan of reorganization, but only condemned the perverse consummation of the plan, for in this inheres the wrong of the present case. The cases are alike in that the same rule of integrity was enforced in both. But there was here no extension of

the rule. And, indeed, it admits of no extension and of no restriction. Its application may be varied as the methods devised by the ingenuity of chicane, but its measure is fixed and absolute. It is the eighth commandment, whose simple text neither needs nor admits of gloss or comment.

Contested in every possible tribunal, State and Federal, delayed for fifteen years, the Trust Company prays that the just decree at last entered in its behalf may be affirmed.

FREDERICK W. LEHMANN,
EDWARD P. GATES, and
GEORGE H. ENGLISH, JR.,
Of Counsel for the Guardian Trust Company.

Office Supreme Court, U. S.
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No. **85.**

IN THE

Supreme Court of the United States.

THE KANSAS CITY SOUTHERN RAILWAY COMPANY,
Petitioner and Appellant,
vs.
GUARDIAN TRUST COMPANY,
Respondent and Appellee,

THE KANSAS CITY SOUTHERN RAILWAY COMPANY,
Petitioner and Appellant,
vs.
CENTRAL IMPROVEMENT COMPANY,
Respondent and Appellee.

Petition for Certiorari and Appeal.

Brief and Argument on Behalf of Shedd et al., Intervening Stockholders of Guardian Trust Company.

NEWELL H. CLAPP,
HARRY S. MECARTNEY,
FOR SHEDD ET AL.

BARNARD & MILLER PRINT, CHICAGO.

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NOTE: The brief below was prepared in the main before we received a copy of the brief lately filed for the Guardian Trust Company bearing the impress of the strong hand and luminous pen of Mr. Lehmann, who first appears in the case at this juncture.

While the cause is therein much more fully presented than it was in the Court of Appeals, as indicated below, nevertheless, the subject is so many-featured and so important that we believe an additional presentation can be appropriately tendered, particularly emphasizing certain features of the record and several very much neglected principles of the law upon the subject.

It is claimed below that the cause of the Trust Company—as, we think, is specifically proven by the opinion of the Court of Appeals—was saved from disaster by the intervention of these stockholders in that court. They are therefore substantial parties to the record here, are conscious also of a substantial place in the case in this court, and will ask a moderate share of the time allowed appellees for oral argument.

Some confusion has crept into the law of liability for floating debt claims in the matter of railroad reorganizations, as particularly revealed in the few late cases; and we believe it is demonstrated below that the judgment in the Boyd case (228 U. S. 482), *as well as the judgment in this case, rests upon an additional ground apparently not mentioned in either of the opinions, because not fully submitted in the briefs; while the judgment in the case at bar rests upon a* THIRD *ground not even mentioned in the* 200 *page brief of appellant.*

We believe that a case involving a subject which could well invite the services of additional counsel as an amicus curiae well warrants a brief submitted by parties who have saved the issue for review by this court, and who are also substantial parties to the record.

NEWELL H. CLAPP,
HARRY S. MECARTNEY.

"THE EVIDENCE"

"THE LONGEST RECORD EVER MADE"—34,614 PAGES

Kansas City Sub. Belt Ry. Co. (Kansas City Southern Ry. Co., Successor) *vs.* **Guardian Trust Co.**

(IN FEDERAL COURT AT KANSAS CITY)

IN THE

Supreme Court of the United States.

THE KANSAS CITY SOUTHERN RAILWAY COMPANY,
Petitioner and Appellant,

vs.

GUARDIAN TRUST COMPANY,
Respondent and Appellee.

Petition for Certiorari and Appeal.

THE KANSAS CITY SOUTHERN RAILWAY COMPANY,
Petitioner and Appellant,

vs.

CENTRAL IMPROVEMENT COMPANY,
Respondent and Appellee.

Brief and Argument on Behalf of Shedd et al., Intervening Stockholders of Guardian Trust Company.

An explanation of the necessity—as deemed existent—of filing a separate brief by stockholders on behalf of the Guardian Trust Company, prompt the following explanation of the position of

The Intervening Stockholders.

Messrs. Charles B. and Edward A. Shedd are stockholders in the Guardian Trust Company to the

extent of $76,700 (P. R. 950, 1006), and they together with one Robert H. Law, a third stockholder, intervened in these proceedings in the Court of Appeals. They not only intervened but did so three different times; and in each instance they were recognized by said court, in the way of formal orders entered in the case upon their petition and of a decision made upon the subject matter or issue tendered by the same.

The *first* intervention was occasioned in this way:

The Belt Company through its receivers in 1900 had filed in the Circuit Court an ancillary bill for an accounting against the Guardian Trust Company, which then held some large notes and claims (about $360,000) against the Belt and held also certain securities as collateral thereto. (P. R., 202.)

After a vast amount of testimony had been taken under a general reference to the master, the Southern Company early in 1905, filed an intervention in the case claiming the collateral held by the Guardian. It claimed that under the "after-acquired property" clause of the foreclosed Belt mortgages the Southern had purchased and acquired such property. (P. R., 269.)

The Trust Company in its answer to such intervention claimed, among other defenses, that the Southern Company was a consolidation of the Belt Company (Par. 17, P. R., 310), and also that its plan of reorganization "legally implied" the payment of the Belt debts and that it could not for this reason recover the collateral at least unless it paid the Belt notes. (Par. 19 and 20, P. R., 311.)

The master after having found the amount of the

Belt Company's debt to the Guardian, viz.: $639,658.86, found against the Southern as to its claim to the collateral except as to the lands of the Central Improvement Company which he awarded to the Southern. He then made a specific finding upon the issue of the Southern Company's liability for Belt debts, viz.: that the Southern was "*not liable in any way*" for said debts. (Par. "Third," P. R., 887.)

The trial court, Hon. John F. Philips presiding, confirmed the master's report and entered a decree in accordance therewith.

In the exceptions to the master's report filed by Messrs. Gates and English the then attorneys for the Guardian (par. "second," P. R., 893, 4), and in their assignments of error in the Court of Appeals ("second," P. R., 916) no exception was made to the *correctness* of the master's finding upon such liability issue, but fault was found merely with the "*inclusion*" of such a finding in the report and decree.

The only explanation of this course of practice on the part of the Guardian's counsel is, that they desired to try such issue in the then pending state court suits, which had been brought at "common law" against the Southern for the purpose; and that they did not realize that in such state of the record a denial of their proposition, or a finding that such an issue *was* a germane one in the case, and hence properly made the subject of *a* finding by master and court, would foreclose them from ever afterwards raising the merits of that issue.

In this precarious state of the record the three stockholders, Shedd and Shedd and Law, filed their petition for leave to intervene in the cause and to file

additional briefs making specific assignments of error upon such issue, etc. (P. R., 950-2.) Said petition set forth the fact that the former counsel for the Trust Company, Mr. Mecartney, had lately called the attention of the regular counsel to the grave situation of the case, but that the suggestion had been ignored and the cause had been argued and submitted in its original record condition. (P. R., 956.)

The Southern, Cambria and Guardian Companies were ruled to show cause. (P. R., 968.)

The Guardian Trust Company filed a written return to the order and together with its adversaries *formally opposed* the raising and discussion of the liability of the Southern as "not in issue" in the case "and can not be determined on this appeal." (P. R., 970.)

The record does not disclose the suggestion or warning of the court upon the oral argument on return to the rule, but it evidently succeeded in changing the counsels' attitude; for they then made formal application to file arguments "upon the merits" of such issue of liability. And the court entered an order setting the cause down for further hearing upon additional briefs. (P. R., 972.)

Evidently recognizing the propriety of not interfering more than necessary with the regular conduct of the case or with its regular counsel, the stockholders' counsel did not press their application to file separate briefs; and having accomplished their main object, left the cause to its regular course.

Later, and while the cause was still under advise-

ment, the three stockholders were impelled to intervene for the *second* time.

They filed a petition (P. R., 973-8), in which they asked that *in case* the court should find the Southern liable, and should reverse the decree upon such issue, it should order the lower court to enter a *final judgment* against the Southern; and that if the pleadings were not in shape to allow this and if necessary thereto the court then allow formal amendments to the answer of the Guardian praying such affirmative relief.

The petition set forth that this suggestion had also been made to counsel for the Trust Company, by its former counsel, Mr. Mecartney, but they had declined to act thereon. (P. R., 976.)

The petition also set forth that notwithstanding the narrow escape of the Guardian from having the liability question foreclosed against it, its regular counsel *had still declined to assign additional error* thereon,—thus trusting solely to the court to exercise *its discretion* to notice a plain error unassigned—and this *against an apparent* lack of desire for it. So petitioner asked leave to formally assign such error on liability of the Southern. (P. R., 974.)

A rule to show cause was duly entered upon the three parties, the Cambria, Belt and Southern. No formal answers appear to have been filed. (P. R., 983, 985.)

Later and on October 22, 1912, the court rendered its opinion on the merits of the entire case. (P. R., 986, Munger, J.) reported in 201 Fed. 811.

The court took advantage of its power "to notice

a plain error unassigned," and decided the question of the liability of the Southern Company for Belt Company debts in the affirmative. It then set down the case for reargument upon the *sole* question of whether the prayer of the *second* petition of the stockholders should not be granted, that is, the prayer for an order upon the lower court to enter a final money decree against the Southern. (P. R., 1004.)

Still later, and on December 21, 1912 (P. R., 1006, 7), said stockholders Shedd *et al.* presented their *third* petition;

It was to the effect that upon the coming hearing the Court of Appeals render a *special finding* that the litigation herein on behalf of the Cambria and Belt Companies had been commenced and prosecuted by the Southern Company, and that the same as well as the intervening petition of the Southern had been prosecuted "without good faith," and had been "trivial, wanton and oppressive"; that the statute as to costs was never meant to apply to such a case; and that upon making such finding the court direct the lower court to ascertain the amount of the Guardian's solicitors' fees and other expenses in defending and attending upon the litigation, and tax the amount thereof against the Southern Company.

This petition also set up that Mr. Mecartney had formally and in print made the claim on behalf of the Trust Company in the trial court; but that the succeeding counsel—as in the other two instances—had declined to present it, either to the lower or upper court. (P. R., 1008-9.)

Under the direction of the court notice of such application was duly given the counsel for the various parties (P. R., 1005); and later when the cause was called for oral argument the court by formal order allowed the petition to be filed. (P. R., 1017.)

Upon application of the Southern Company that its counsel be allowed at the approaching hearing to reargue the question of the Southern's liability, it was so ordered.

The cause was then orally argued in January, 1913, at St. Louis upon three issues viz.:

1. The liability *vel non* of the Southern. (Reargued.)
2. The power of the court to order a final money decree against the Southern. (As per the second petition of Shedd *et al.*
3. The question of the taxation of solicitors', etc. fees as costs against the Southern (as per the third petition of Shedd *et al.*)

Later the court rendered its second opinion in the case (*per curiam*), reported in 210 Fed. 696.

It reaffirmed its holding of liability against the Southern; and secondly, it ordered an affirmative decree against it for the amount of the Guardian's claim and decree against the Belt.

The third question—as to taxing solicitors' fees and other expenses, etc.—it left open, and directed the lower court to adjudicate that issue according to the "principles, rules and practices in equity," etc.

But in disposing of the case the court could not

help finding that the litigation so occasioned by the Southern was "baseless and unwarrantable."

These stockholders therefore feel that their efforts have been the means of preserving for decision the main issue in the case, viz.: the question of a decree now amounting with costs to nearly or quite $900,000 in money against the only solvent debtor, and also of presenting and preserving the two other vital issues and claims.

Counsel for these stockholders, as is borne out by the record, have meant to refrain from undue interference with the regular order; but they now seem to see a definite opportunity to shorten the labors of this court in outlining and briefly arguing two much neglected features of the case, as they see it and attempt to prove below.

It is not necessary to account to this court for the fact that the Guardian's case was presented in the Court of Appeals in such a prejudicial manner.

It is, however, but an appropriate courtesy to be shown Messrs. Gates and English, who first lodged the case in that court, to point to the affidavit of Shedd, stockholder (P. R., 954), and the facts alleged therein, that the Guardian had come under the liquidating control of one Prescott; that he had formerly represented Mr. John W. Gates and his counsel, Max Pam, Esq., who as stockholders had attacked the Guardian Trust Company and caused a receiver to be appointed for it and who also at the same time had become influential members of the Southern reorganization committee. After such committee with the use of its express promise to pay the floating debt, etc., had procured sufficient deposits—the Guard-

ian's bonds and stock included—to assure the success of their plan, they declined to pay the Guardian's debt. Upon the hearing at St. Paul, Messrs. Gates & English (P. R., 980) claimed in defense that they had submitted the question of legal policy as to whether the issue of the Southern's liability should be raised on the appeal to the executive committee of the Trust Company—of which Prescott was the dominating power—and had been ordered not to do so, and that after that issue had been again raised by the rule to show cause under the first petition they had been again ordered not to do so, and to oppose the rule.

It may occur to this court that it would have been better for these stockholders to move for a receiver of the Guardian and thus to wrest control of the litigation from those who had so prejudiced its interests rather than to ask or expect the Court of Appeals and this court to welcome a suitor with divided counsel. But the litigation is old, such a stockholders' controversy a burdensome one at best, receiverships costly, stockholders widely scattered, etc., etc. And if the rights of said company can be preserved in this court at the expense only of the inconvenience of an appearance by extra counsel, the court, we feel sure, will gladly submit—as the Court of Appeals did—to such slight inconvenience.

The Character of This Litigation.

Although the evidence upon the main branches of this suit was not taken up on appeal to the Court of Appeals, Judge Sanborn and his able colleagues in answering the Southern's claim of laches, find

occasion to characterize this cause in its main features as a "baseless and unwarrantable suit"— and this obviously upon the face of the record.

Pages 31 to 51 inclusive of appellant's brief are largely devoted to attacking this finding.

The chief question presented here emerges from a record the like of which the world has never seen, and out of a veritable mountain of "evidence,"— totally useless for lack of a valid or colorable bill to which to apply it. And common courtesy to this court may demand a brief or outline "accounting" for a record of such magnitude found in the end to have been useless, and hence a useless and colossal waste of judicial and professional energy.

We prefix hereto a photograph of which a duplicate was annexed to the second petition of these intervening stockholders (Orig. Rec., 1167). It should afford food for profound meditation.

36,000 pages of "evidence" (the master's finding, P. R., 579.) The longest record ever made—*and made upon a hopelessly bad bill of complaint!*

Such a thing—happening, too, in a Federal Court!

It challenges the entire American Bar to a reckoning—and a reckoning wide and deep. For such a record could not be attributed to the work of one man nor to one official. *Such a record* is produced by *conditions*—**it must needs have had a soil to grow in.**

And what was the *theory* on which the colossal record was made?

Namely, that ever since the organization of the Belt Company and the Guardian in 1889, the two

companies had had largely the same persons as directors, and that usually a majority of the directors in one company constituted a majority in the other, etc.

Therefore, the Trust Company had always *"dominated"* the Belt Company and all its constituent and subsidiary or associated companies; and *therefore,* all the transactions between them were "fraudulent;" *therefore,* the Trust Company was in law "a trustee" in managing the affairs of the Belt Company, etc., and hence liable to re-account for *all* the transactions of nearly a dozen years, all in the face of the facts that each and all of the companies had kept their books up to date—each item having been explained at large as entered, etc., the "voucher system"—and had checked them up with each other from week to week and the books *had tallied to a cent.*

Incidentally, the Trust Company was restrained the same day the original bill was filed by order of the court (Hon. John F. Philips, Judge, presiding) from selling the notes of the Belt Company which it then held and the collateral held by it as security for such notes, which—including an open account of over $31,000,—amounted to about $360,000; and said order continued in force up to the entry of the original decree herein in 1910. (Incidentally, too, the restraining order was issued upon a $10,000 bond. P. R., 31.)

In the amended intervening petition of the Southern Company filed in March, 1905, after over a third of this huge record had been made, and by which the Southern Company sought to recover certain property, this theory of "domination" is repeated.

The justices will wonder when told that it was not claimed in the ancillary bill in any of these "domination" pleadings, either (1) *that the Trust Company at any time ever held a majority of stock in the Belt, or even a respectable minority thereof,* or (2) *that any ring or set of men had caused the Trust Company to dominate the Belt to their financial interest,* or (3) *had caused the Trust Company to cause the Belt to enter into unfair or fraudulent "promoting" contracts with them,* or (4) that they, by reason of having a much larger interest in one corporation than the other, had *caused such unfair contracts* to be made in consequence of which they had received an undue financial benefit, etc. (These are the only four classes of so-called domination cases which we have heard of.) *But that the entire charge of "domination"* and resultant fraud and unfairness is based *solely upon the averment that during the entire period of eleven years covered* by the accounting, *the stockholders of each corporation*—presumably adult and not under duress—*happened to "elect" largely*—and not wholly—identical *directors* (P. R. 103); that **therefore and thereby** the entire transactions between the two companies, all open and unconcealed, all spread at large and *in duplicate* on the books of each company (they "tallied to a cent" (*master's finding,* P. R., 648, "j") *—were constructively "fraudulent,"* no matter whether approved by *the officers of each company, balances settled for by note, no matter whether older than the statute of limitations, etc., etc.*

Of course, the court will see that it would be just as easy and just as logical to say that *thereby* the

Belt Company had "dominated" the *Trust* Company, and there would be just as much excuse for a bill by the latter and just as much excuse for a $23,000 reporters' bill *and a* $25,000 *master fee*, and a large fortune spent in lawyers' fees and other expenses.

The strange thing about the master's report is that he finds the fatal insufficiency of the bill upon its face—he finds no legal sense at all inherent on its sole theory of domination—and then devotes some several hundred printed pages to finding from the evidence that there was no domination in fact!

He mentions (P. R., 646) the four classes of "domination" cases scheduled above. He then 'distinguishes" this case therefrom, by setting out (pages 647-9) *some thirteen "Controlling Facts" "which appear on the face of the bill, or are practically undisputed in the proofs"* numbered "(a)" to "(m)", *most all, if not each of which, would have been a complete defense* **if** *a good or prima faia cause of action* **had** *been stated in the* **first instance!**

(Of what use such an elaborate report could be can not be imagined—although the labor involved in its preparation probably justified the unusually large fee allowed.)

In other words, *the bill is at war with a well-known condition long common to the entire country.* And if it were good, *almost every large corporation* in the country would be held liable to *"account"* to every other corporation with which it had done business and whose directors were largely common to both, and no matter how many, how old or how open or often settled the transactions had been. Such a

ruling if generally enforced would, as it is easily perceived, overwhelm and *paralyze the courts of the entire country and throw them into chaos.*

No more pitiful object lesson of what may come of a deliberate and wanton court assault can be given than this record, and the picture of "The Evidence" taken in the court below. A large trust company and a railroad company have daily transactions; have their books kept practically in duplicate; each item *explained at large in duplicate* on each set of books; the books tested and made *to tally* week after week, and year after year; *notes given* to balance; the transactions *expressly ratified* by stockholders and directors from time to time; and then after *eleven years* of such transaction, when the books reveal 10,000 or 12,000 items, *both explained and closed* upon the *face* of the entries, the one company with a dry and meaningless theory of "domination and control"—not a charge of fraud but a mere *excuse for a cry of* fraud—drags the other company into court and puts it to the burden of "accounting," that is, of *explaining* again and proving *over* again, each of the 10,000 or 12,000 items! (P. R., 580.)

We repeat, "*The longest record ever made,*" *made upon one of the most baseless bills ever lodged in court!* A bill found bad for *thirteen defenses* "*either appearing on its face or practically undisputed in the proofs!*"

The Injunction Suits.

In the case brought in 1900 to foreclose the Belt mortgage, the Guardian had been made a party by reason of its having been a co-trustee with the

Provident Life in the mortgage. In addition to its formal answer as trustee, it asked leave to file "an amended and supplemental answer," in which it set up that the foreclosure was simply a part of a reorganization scheme and of a probable intent on the part of the reorganizers to use the prospective decree to embarrass the Trust Company and other Belt creditors in asserting their claims against the prospective purchaser—the Southern. The application for leave to file was denied with the following stipulation inserted in the decree to *protect* and *insure* against future questioning the company's *clear right to sue* the Southern, viz.:

> "This decree is entered on the *express condition to which the complainant has assented, that it shall be without prejudice to and shall not bar the right of the Guardian Trust Company, or its receiver, to plead and insist* **in any** *litigation now pending,* OR **hereafter brought,** *that the Kansas City Southern Railway Company, by virtue of the manner in which it was organized, or for any other reason, is legally or equitably liable for and* **bound to pay the unsecured debts** *of the Kansas City Suburban Belt Railroad Company,"* etc.

Early in 1905 the Guardian brought state court suits based upon such claim of "liability." In July of that year Mr. Moore, on behalf of the Southern, filed a supplemental bill in said very foreclosure case to enjoin the prosecution of the Guardian's state court cases.

In the face of this plainly worded stipulation the injunction was issued by Judge Phillips and the same deliberately accepted by Mr. Moore for the Southern!

The Court of Appeals held the injunction without merit, (1) upon the face of the record, and also (2) by reason of the stipulation, which it held controlled in *any* event, and this, of course, without argument or analysis. It evidently was one of those instances where a thing was too plain to admit of analysis or argument. (146 Fed. 337.)

———o———

What next was done to keep "the issues" and *all* of them in the United States Court under the direction or control of Judge Phillips and before Master Douglas or involved—or buried beneath—the awful pile of evidence, or, as we call it, "dust"?

It seems that when the state court cases were nearly reached for trial after all manner of dilatory pleas and motions had been made in the state court and the case had been finally set for trial on a specific date, Mr. Moore filed a supplemental bill by the Belt and Southern *jointly* (*claimed* by him to be *independent* companies) to *again* enjoin the state court suits.

It was sought not only to enjoin the two suits in which the Belt notes held by the Guardian were involved, but a *third* suit based upon the notes of the *Pittsburg and Gulf company which notes were not involved and* **not even mentioned** in the accounting case in the Federal Court was sought to be stayed.

Judge McPherson enjoined **all three** *suits!*

And incidentally, too, upon a $10,000 bond!

It is no wonder that the Court of Appeals held that the injunctionary order lacked not only a legal

basis but also involved an *abuse of discretion* on the part of the hearing judge—was "whimsical and arbitrary." (See *G. T. Co.* v. *K. Cy. South. Ry. Co.*, 171 Fed. 43.)

It therefore apparently, if not conclusively, appears from the record alone that an abnormal wrong has been committed here—invited and the results deliberately accepted by counsel for the Belt—Southern interests.

The "Scheme".

The following are extracts taken from our brief upon the application to tax solicitors' fees, etc., prepared for the Court of Appeals:

From the references made in our petitions here, and particularly to pp. 21 to 31 of our first petition, and the merest skeleton history of the case, shown by the record confronting this court, we have here the following consummated "scheme," (borrowing a term from the Belt pleadings), viz:

1. The Trust company having been the financial agent of the Belt Company for over eleven years, keeping accounts with the latter practically *in duplicate*, etc., finally winding up in 1900 with a net balance of notes held against the Belt, and also an open account, both aggregating nearly $400,000.

2. A reorganization plan then promulgated, which took in the Gulf Company, as well as the Belt Company and the Port Arthur Channel and Dock Company.

3. This reorganization plan broadly announced that one of the "*results*" to be "*attained*" was "*the payment of the floating debt,*" etc.

4. This open promise was enough to prompt the deposit under said plan of practically all the Belt securities, including securities held by the Trust Company to the extent of some hundreds of thousands of dollars.

5. *After* such deposit, a change of personnel and dominating management in the railroad companies, and of the reorganiaztion committee; then a *repudiation* of the Guardian Trust Company's debt, under the leadership.

6. Later, September, 1900, the Cambria Company bill filed—instigated, of course, by the same reorganization coterie representing the Southern—praying for receivers for the Belt Companies, attacking the collateral held by the Trust Company, and making all sorts of baseless "domination" charges against the Trust Company, etc.

7. A restraining order at once issued against the Guardian, restraining it from selling the notes, or disposing of the collateral.

8. Appointment of receivers for the Belt, and its constituent companies.

9. Receivers for various "auxiliary," though independent companies, viz.: the Amusement Company, the Elevator Company, the Townsite Company and the Central Improvement Company.

10. The Trust Company thus embarrassed by having such large claims tied up, insolvent several months later, and a receiver appointed for it in the "Bierce" case.

11. The filing of an ancillary bill on the part of the Belt Company receivers, and later an amended

and supplemental ancillary bill, in the latter of which charges of "domination" are repeated and an accounting asked as to specific transactions, all aggregating above $8,000,000. (P. R., 237 to 309.)

12. The filing of the intervening petition *renewing* charges of "domination" and then later, by amendment making a claim of a *breach of trust* by the Guardian, as *active* trustee in the Union Terminal mortgage, and a resultant liability claim lodged against it for over $1,000,000, etc.

13. The two outrageous injunctions issued later enjoining the state court suits.

14. Over 36,000 pages of "evidence" taken.

The Results:

From this remarkable litigation have been that the Southern Company and its agents and attorneys have succeeded:

(1) In destroying the business of the Guardian Trust Company and forcing it into liquidation.

(2) In holding it out of its claim against the Belt Company for over *twelve years* (now over fifteen years).

(3) In making the biggest court record ever known, and thus causing the Trust Company collossal costs, even before *a decision* had been reached upon the merits of the proceeding. All this upon a baseless and legally meaningless complaint.

(4) In deferring the collection of its collateral, or the realization thereon for over *twelve years* (now over fifteen years).

(5) In imperiling the *value* of its said collateral by appointment of *receivers* for a number of com-

panies, in which stock was so held, and holding such companies in receivers' hands for years, largely under control of the same counsel representing the Belt Company (even in the final decree they were allowed sums as counsel to the Central Company receiver. P. R., 1062.)

(6) In having the administration of said independent receiverships thus joined in one proceeding of oppressive dimensions, increasing or multiplying the burden and difficulties of contesting or attending upon the same.

8. In having the prosecution of the only suits begun against the only solvent debtor—the Southern—enjoined—the first injunction having been granted against the *express and formal* stipulation in the foreclosure decrees, thus violating the *sacred compact of the court itself.*

9. In having said suits a *second* time enjoined.

10. Said restraining order and the two injunctions having each issued upon a bond of but *$10,000.*

11. In having been enjoined from prosecuting its suits at law based upon *Gulf* notes—a suit *in personam and a claim in nowise involved* **or even mentioned** *in the pleadings in Federal Court case.* (P. R., 646.)

The question then is whether a docket fee of $20 *(Statutory costs) allowed the Trust Company for all this damage and loss satisfies the situation or limits the court's power for justice in the premises.*

———o———

It is this wretchedly "baseless and unwarrantable litigation—this purported "trial" of "issues" which

Mr. Moore for the Southern calls "commendable from every standpoint!" (p. 51.)

The Intervening Petition.

The claim asserted in the intervening petition—under the "after acquired property" clause—was somewhat unique for this day and generation in that the most of the property claimed was *personal* property unconnected with the Belt road or its equipment or operation, and, too, personal property of a *chose in action class* as notes, accounts, stock, coupons, etc.

The "domination" theory of the ancillary bill was also repeated here as a reason why the Guardian should not be allowed to retain its collateral. (P. R., 173-183.)

In the answer of the Trust Company four general lines of defense were set up:

First, that the property sought was of an intangible, chose-in-action class, and that the lien of the mortgages had never attached thereto.

Second. That the intervenor had been guilty of laches in not asserting its alleged claims until nearly three years after the purchase at foreclosure sale. (P. R., 198-201.)

Third. Limitations, and,

Fourth, and lastly, that

(a) the stocks, bonds and accounts in question had been actually and formally turned over to the Trust Company to secure a *bona fide* debt due and owing from the Belt to the Trust Company;

(b) that the Southern Company was in fact but *a*

consolidation of the Belt Company, either *de jure* or *de facto,* and hence was not a purchaser for value, and in fact stood in the shoes of the Belt Company;

(c) that as the Belt Company had no ground to recover the property, the Southern had none; and

(d) that since the reorganization committee of the Southern Company had expressly promised to pay the floating debt of the Belt Company, it should in equity be required to pay the claim of the Trust Company (p. 33); and

(e) that the plan of reorganization and exchange of stocks, etc., *legally implied* the payment by said Southern Company of all said claims, etc.

The Issues Here Involved.

If the Guardian Company is a consolidation of the Belt, or if it be liable on any ground for Belt debts, this alone would dispose of the issue of Central Improvement lands, independently of perhaps a separate ground outlined in the first opinion of the Court of Appeals (Judge Munger). We, therefore, pay no attention to such issue or feature of this controversy.

We also pass over the question of the right and power of the Court of Appeals to review the "liability" question, for lack of more specific exceptions and assignments of error, etc., as the opinion and its citations overwhelmingly sustain it.

We also leave to other hands the technical ques-

tions of the jurisdiction of the appeal and the propriety of reconsidering the merits upon certiorari.

The principal occasion for our presenting a separate or additional brief here in behalf of the Trust Company is this:

The liability of the Southern Company, as we affirm, rests upon three distinct grounds:

1. An *express* provision in the reorganization plan to pay the floating debt of the Belt,—which we assert became effective upon the deposit of stock—*i. e.*, upon the *first step* being taken under the plan, and in any event upon formal possession taken later—rendering all questions of sonsolidation or liability under *other* grounds really immaterial in this case.

2. The fact that the Southern is a *consolidation* of the Belt, and is therefore liable *at law* under Missouri *statutes* for the said floating debt.

3. Upon the general equities as revealed in all the facts and circumstances attending the reorganization, foreclosure, value of stock and assets, etc., etc.

The third ground is the one which is so strongly revealed in the opinions of the very able justices of the Court of Appeals; and these exhaustive opinions reveal so much of argument and authority upon the various features and elements outlined and discussed, that further argument here would be useless if not tedious.

But what a labor was involved in their work!

Now we seek to outline and empahsize in this court the *first two* propositions, upon which the judgment of that court can as validly and firmly rest and which are capable of far briefer demonstration.

And we claim indulgence for our separate effort here upon the plea that we mean to save the court some labor, and to emphasize several woefully neglected principles embodied in railroad reorganizations—principles which if now recognized by this court would help to set at rest many oft recurring questions upon this many featured and complex subject and save a vast amount of time, labor and cost in railroad financing and railroad controversies.

Two independent and dominating issues in this case, as we see it up to the present writing, *still remain neglected:*

Nowhere in the briefs filed heretofore in the Court of Appeals is the *one vital clause of "payment of the floating debt"* at the beginning of the plan put forth *distinctly* as a *separate* point and as a *controlling feature* of the case *in and of itself,* and the controlling principles of construction applicable to this issue outlined and briefed up.

In other words, almost the entire argument of the Trust Company heretofore has been to show that the reorganization plan in *all* its vast *details, features and figures* is thoroughly *consistent* in respect to its *expressed* purpose to pay the floating debt—a conclusion with which we heartily agree; and we believe that the various efforts of Messrs. Untermeyer and Moore to show the contrary have been successfully met in detail.

But we desire to emphasize:

1st. **That it is unnecessary** *for the Guardian Trust Company to undertake, or for this court to*

undertake the inordinate labor involved in this study; that the **one clause** *in the plan expressing as one of its* **objects "the payment of the floating debt"—***with well known and settled* **rules of construction applied** *to the document*—**controls of itself the entire case.**

We seek to emphasize:

2nd, **That the Southern Company is a consolidation** *of the Belt Company* **not only** (1) *a consolidation* **de facto,** *but also* (2) one **de jure** under *Missouri statutes.*

So far as the concrete results in the case is concerned, a recognition of either of these propositions would obviate the great labor of reviewing the record on general equitable grounds.

The brief has been prepared after an exhaustive study of the subject and the cases, but with an attempt to draw the lines close around the heart of the subject and avoid the unnecessary consideration of "wearisome details," which has so heavily consumed the patient labors of the Court of Appeals.

Outline History of the Consolidation.

The history of the construction of the properties of the Belt Company, the Gulf Company and the Dock Company, and of their subsequent absorption by the Southern Company, presents only another concrete and very apt illustration of the advantages of combination and co-operation which is so frequently exhibited in our modern industrial or corporate system.

A railroad connecting Kansas City and Port Ar-

thur, without its own terminals and depending upon contracts with other companies for its terminal facilities, was an incomplete and financially marred proposition.

Terminal companies which had to depend on one or a few companies for the making of terminal contracts in order to live were likewise, by this fact alone, much handicapped financially, no matter how great the physical advantages of their properties.

The three properties being recognized as physically or naturally portions of one general enterprise, the advantage of making them legally and technically one was easily apparent.

As many stockholders and bondholders in the one company were interested in the others, and as many bondholders in each company were also stockholders therein, it was also obvious that any arrangement for unifying the three systems, in order to be quickly carried out, would have to include or "take care of" both the bondholders and stockholders of all companies.

Hence, as we shall later see, the plan adopted did include all such bondholders and stockholders of all or any of the companies, who chose to deposit their bonds and stocks thereunder and participate therein.

Again, the floating or unsecured debts of the three companies being very small in comparison to the aggregate value of properties involved, it was clear that any attempt to "freeze out" the unsecured creditors and reserve to the stockholders an interest in the combination or its results to the prejudice of such creditors would have been not merely illegal and a fraud, but also a foolhardy experiment.

To have the immense properties tied up by various parties filing bills, not only seeking to stop the reorganization proceedings, but having a real legal basis therefor, would not have been the policy of modern business men.

It was therefore natural that the plan for the "unification" of the properties not only contained no express repudiation of such debts or claims, and not merely silently recognized the obligation *which the statute cast* upon the consolidation for such debts, but, in order to allay all fears and to invite the fullest co-operation on the part of stockholders and bondholders having "open" claims against the companies, or either of them, contained an *express* avowal of the intention to "*pay the floating indebtedness,*" and attempted to make allowances and provision therefor.

And, again, it was quite natural to find the Guardian Trust Company, a large if not the chief single "open" or poorly secured creditor of the Belt, declining or refusing to come into the plan and deposit its stock and bonds until assured that its debt would be paid.

And this assurance was claimed to have been actually given, not only by the express provisions of the plan itself as finally modified, but also orally by the mouths of Mr. Pam and others on behalf of the reorganization committee.

It is upon this oral promise that the claim is made on behalf of the Trust Company that "the reorganization *committee* expressly promised" to pay the Belt debt due the Trust Company.

To one moderately well acquainted with the his-

tory of railroad organizations, or to almost any modern, well versed business man, it is clear that the plan adopted in the instance of these three corporations was, at least in its general aspects, a wise one.

About, or over, 97 per cent. of Belt stock, and about 89 per cent. of the bonds of said company, and proportionately large blocks of stock and bonds of the other two companies, were deposited under the plan.

Progress was apparently made swiftly and harmoniously until the open repudiation of the reorganization committee in the summer of 1900 of their liability for the debt due from the Belt.

The unwisdom, if any, in the policy of the reorganization commenced at this point, and arose *in carrying out* the plan *and not in the formation of the plan itself.*

Prior railroad financial experience had done its share in demonstrating that financial "honesty was the best policy." In particular it had demonstrated that neither (1) the "wrecking" policy of a Vanderbelt nor (2) the "secret and concealed profits" policy of a Jay Gould, nor (3) the attempt to freeze out floating creditors to the profit of old stockholders (as was attempted in the Howard case, 7 Wall. 392), was in the end a paying policy. Railroad managers had largely outgrown these "tricks of the trade."

It had demonstrated more, viz.:

That while *bondholders* of a railroad corporation had a legal right to force its property to sale in default of payment of interest, etc., yet as a matter of

fact the damage and loss, direct and indirect, from thus having the company in the hands of a receiver for months, and possibly years, the natural growth of the enterprise suspended, the loss of credit, the expense of a stubbornly contested foreclosure suit, etc., were usually so great that such a proceeding was scarcely ever justified or profitable from any standpoint.

The floating debt of railroad companies being ordinarily so small in comparison to the great value of the properties and the usual large dimensions of the enterprise, the law making "preferred" the recent open claims arising, sometimes within six months, sometimes a year, prior to the foreclosure, the fact that bond interests and stock interests were so often and so largely held in the same hands, and the great damage to the large property from a contested and long drawn out foreclosure, etc., all resulted in most instances in the adoption of a policy of reorganizations along the lines of a readjustment of bond and stock interests, *with* the payment of floating debt.

In other words, no matter what the specific legal plan adopted might be, the general readjustment plan usually adopted in later years of railroad finance was in effect a "scaling" or readjustment of bond and stock interests and a payment of floating debt, etc.

Sometimes, a foreclosure was used as an *incident* to this general plan in order to satisfy the rights of non-consenting or non-depositing bondholders or stockholders in the assets transferred, and thus fully and technically complete the general scheme. But

an open repudiation of floating debt, as the list of *post* panic cases (*post* 1893) shows, was a rare exception.

In England a formal recognition of the public interest in having railroad companies going concerns, and continuing them as such, together with the general financial profit in recognizing the scaling or readjustment process as one naturally allied to such enterprises, etc., has led to the adoption of an almost universal plan of allowing bonds and stocks to be scaled and readjusted without foreclosure, and even in spite of the protests of minority holders, etc.

In America the same result is attained through the co-operation of bondholders and stockholders; except that the want of legal power in the majority—and the absence of a railroad commission having the requisite legal power—to force the minority or the occasional dissenter to yield to the new arrangement thus often raises complicated questions respecting his rights, or occasions a foreclosure in order to satisfy them—an expensive proceeding and a useless incumbrance upon the whole railroad financial system.

It is time for American states to avoid this useless waste and to charter railroad corporations—or at least cover the matter of their bond and stock issues—in a manner somewhat patterned after the English system.

One thing seems clear on the present case, viz.:

That the foreclosure of the Belt road not only consummated, but commenced long after the deposit of substantially all of the Belt stock and bonds and the

flotation of all securities of the new company, was an act of questionable business merit. It entailed thousands or tens of thousands of dollars of direct expense, kept the whole financial scheme affecting the three large properties from technical fulfillment —or at least kept some technical rights in the property unsatisfied—for the space of several years, and thus resulted in much indirect damage and financial loss, which it is hard to fully estimate.

It was obviously unjustified unless there was no other way of legally satisfying the rights of the 3 per cent. of non-depositing Belt stock or the 11 per cent. of non-depositing Belt bonds.

That there was such a way, and a very simple way, is clear.

As to the non-depositing stockholders, all the new corporation (or the committee controlling it) had to do was to allot them their quota of new stock, or allow them dividends thereon, if they chose to receive them. They could "take it or leave it."

As to the 11 per cent. of non-depositing bonds, they could have been ultimately paid without loss; for the new allotment to Belt bonds was 58 per cent. more of Southern bonds.

There was no real object in prosecuting the foreclosure case in order to attempt to wipe out the floating debt; since the plan expressly recognized it, and it will be shown herein that independently of this fact, the new company was made liable therefor.

The Agreement.

The reorganization "Agreement" (copy annexed to the Plan) was dated June 14, 1889, and published August 17, 1899.

Its main objects were:

(*a*) To show that it was necessary to "the protection of the interests of the holders of the *stock* and bonds of said railroad" (the "Gulf") and terminal companies, that said three corporations "should be, by means *of consolidation*, or stock control, or in some way, *united* and legally placed under the practical *management, direction and control of one corporate organization*, with, if possible, but *one class of incumbrance* secured upon the whole system, and *one set of shareholders.*" (P. R., 821.)

(*b*) To constitute a reorganization committee, with the fullest and broadest powers in respect to such general scheme.

(*c*) Such committee was to act for the benefit of such bondholders and *stockholders* as should deposit their stock and bonds under the agreement. (*Idem.*)

(*d*) Said agreement contemplated the adoption of some *specific "plan"* by the said committee, to be published in due course.

(*e*) It was to be "the *special duty* of said committee" "to prepare and adopt a plan for the reorganization" of said "three companies and their *properties*, and for the *consolidation of said corporations*, * * * either *with or without foreclosure*, of either or all of said properties, or by means

of the *acquisition of the stock* or other securities of either or all of said corporations," etc. (P. R., 823.)

Such agreement was, and the plan was to be, *primarily* for the benefit of the depositing bondholders and stockholders of the several companies involved.

The former had liens on the property; the latter control thereof.

It was not necessary, therefore, to appeal to others interested to further the plan. If the plan to be adopted *involved* the payment of floating indebtedness of the companies, the interests of such creditors therein were fixed and definite.

On the other hand, the various complexities of any plan to be adopted would run up to a goodly aggregate; and it was quite probable that some parties interested should make some *special* claims by virtue of the express wording of the agreement or plan or contracts, etc., to some lien, right or priority, etc., to which they were not entitled upon the merits of their claims alone.

It was, therefore, but natural caution for the committee to announce (Art. 12) that "*no right is conferred* nor any trust liability nor obligation (except the agreements herein contained in favor of the holders of certificates of deposit hereunder) *is created* by this agreement or the plan or *is assumed hereunder*, or by or for any new company in favor of any bondholder or any other creditor or any holder of any claims whatsoever against the said companies." (P. R., 823.)

This clause, therefore, cannot be treated as a repudiation of any legal or valid claim that might *at-*

tach by law upon the execution of any certain plan of the committee.

The specific plan was not adopted at the time, nor even outlined.

The committee was given the widest possible powers in respect to plans and adjustment of all claims and the adoption of methods and the control of properties.

Hence, it was fair to assume that the plan to be adopted would be absolutely legal and equitable to all parties concerned.

This clause did not, nor did any other, bind the committee to a plan which would be *fraudulent* to any creditor or infringe any person's rights; nor did it require the committee *to exclude* any creditor or class of creditors from consideration.

No right was "*conferred*" or "*created*" by virtue of the agreement—no *new* right. *It is not stated that* **the** *plan* **to be adopted** *would deny any existing rights.*

That this was the sense of the clause in question is substantiated by the remainder of the paragraph, in which is specified "claims in favor of any company now existing or to be formed hereafter" (*e. g.*, the Southern Company, as well as others), "whether such claim be based on any bonds, coupon stocks, securities, lease, guaranty, or otherwise, with respect to any *security* deposited under this agreement or any moneys paid to or received by the committee, or by the depositor hereunder, or with respect to any property acquired by purchase at any foreclosure sale, or with respect to any new certificates to be is-

sued hereunder, *or with respect to any other matter or thing.*" (P. R., 823.)

This clause, if read as a repudiation of legal liabilities, would be so sweeping *as to be ridiculous upon its face*. Any plan to be adopted would involve the committee and the new company in *some* rights and even *some* duties in respect to such moneys or securities or *some* "other matter or thing."

The import of this paragraph is to exclude parties other than the depositors from *sharing with* the depositors in the *plan itself* and as active parties thereto. It was proper and natural exclusion of non-participating stockholders; it involved no fraud on them, and so as to bondholders not participating.

This view is also evident from the wording of the next (13th) article, which, after providing that the committee shall hold all moneys paid under the plan or agreement for application to any "purpose as may be most convenient," and that "nothing in the plan shall be understood *as limiting or requiring the application of specific moneys to specific purposes,*" proceeds thus: "Any obligation in the nature of *floating debt*, or otherwise. * * * or any securities held as collateral for any such obligation, may be *acquired* or *extinguished* or *held*"—*i. e.*, purchased, paid or held—"by the committee at such time, in such manner, and upon such terms as they may deem proper *for the purpose of carrying out this agreement.*" (P. R., 823.)

If there were any doubt as to the proposition that the prior article did not extend to a clear repudiation of ordinary or unsecured creditors, it would be dispelled by the language just quoted, to the effect

that the committee could acquire, extinguish or hold "*floating debt*" claims *for the purpose of carrying out the agreement.*

The next clause is, "and nothing in said plan and this agreement contained is intended to or shall constitute any liability or trust in favor or in respect of any such obligations so *acquired or extinguished or held* by the committee." (P. R., 823.)

If this latter clause means anything, it does not, at all events, affect such claims before they shall have been sold or transferred to the committee, for it is an "acquired, extinguished or held" claim that is referred to.

Therefore we observe as to this feature of the agreement:

1st. There was no express repudiation of any creditor's claims in respect to any plan thereafter to be adopted, provided such *plan properly involved* the payment of such claims.

2d. On the contrary, the committee was given power to "acquire" floating debt (and all other class of claims) "for the *purpose* of *carrying out*" the purpose or plan.

3d. Any claim upon the part of the Southern Company, which grew out of such agreement, that it did constitute such repudiation in order to bar a creditor, who as stockholder had joined therein, or any one else from claiming his debt, would have to be based upon *clear and unmistakable language.*

4th. If the agreement had contemplated any such repudiation and the subsequent plan of the committee contradicted it, or manifested an intention to

take care of floating debt, *the latter* would prevail, as the former was only preliminary and general, while the latter was the specific plan. The later supersedes the earlier; the specific displaces the general,—the positive and equitable the negative and fraudulent.

The Plan.

The essential features of the published plan of November 7, 1899, so far as we are vitally concerned therewith, were these:

1. That the "Gulf" road was to be purchased by the committee at foreclosure sale and it was "to be *conveyed* to a successor company." (P. R., 815.)

2. "The *stocks* and bonds" of the Belt Company "and its constituent companies deposited hereunder" were also to be "conveyed" to such successor company, "*if sufficient* are so deposited to warrant the retention of that property by the new company, and said new company will issue *in payment thereof* the new securities (bonds and *stocks*) hereinafter mentioned, to be "disposed of" (distributed) "as hereinafter stated." (P. R. 815.)

"*by this means, therefore, the following* **results**," as it was *expressly* stated, "*will be* **attained**":

(*a*) "The new company, which will own the main line" of the Gulf Company, will "also own the bonds and *capital stock* of the Belt Company, and the bonds of its constituent companies, and the bonds and stocks of the other terminal company, the Dock Company, "and *thereby* all three properties will be under **one corporate ownership, management and control.** Said bonds and stocks so purchased will be pledged under the new first mortage to be created."

(*b*) **"The payment of the floating debt** *and existing Car Trust obligations."*

* * * * *

(*d*) In case the terminal *properties* are not *so acquired,* then other terminal facilities to be secured for the Gulf road.

"It is intended, as soon as practicable, that the new company acquire the properties of the terminal companies *in fee* and bring them directly under the lien of the mortgage." (P. R., 815.)

This last clause is the nearest reference to any contemplated foreclosure of the terminals contained in the whole plan. Such "acquirement" might be by direct purchase or deed, or certainly by complete consolidation; and hence such clause is not a specific statement of any contemplated foreclosure, although it *includes* or allows a plan of foreclosure *prosecuted in the interest of the consolidation or general scheme.* "Consolidation *with* or without foreclosure" is the language of the agreement (see clause "e" of the Agreement, *supra*).

3. (p. 3.) The new company, "as a consideration for the property and *securities*" (*i. e.,* bonds and *stocks*) "to be conveyed or delivered" to it, or which it "shall acquire," was to issue:

"*First.*" First mortgage bonds, $30,000,000, etc.

"*Second.*" *Preferred stock,* $21,000,000.

"*Third.*" Common *stock,* $30,000,000. (P. R., 816, 817.)

* * * * *

4. "By this plan the *cash requirements of the new company and the reorganization* will be provided as follows:

By sale of $3,000,000 first mortgage 3 per cent. bonds and $3,000,000 preferred stock $3,500,000

From payments of $10 per share by participating stockholders of the syndicate	2,400,000
	$5,900,000

To be applied as follows:

For payment of car trusts and interest adjusted to date of payment, *say*	$1,900,000
For payment of floating debt	475,000
For payment of receiver's certificates	800,000
For payment of first mortgage coupons, due April 1, 1899	575,000
Working capital and expenses of reorganization	2,150,000
	$5,900,000

(P. R., 820.)

Now, it is contended on the part of the Southern Company's counsel that in any event this latter itemization would limit the payment of floating debt to the sum named in the item so technically specified, viz: $475,000.

But this cannot be so. The specified allowances were merely *estimates*, as much so as if the word "say" in the first was repeated after each item. It is usual in itemizing estimates to put this word at the end of the first item of a schedule, inferring its repetition as to the others.

It is to be noticed that the estimates given are all in round numbers, not pretending to be exact and to cover interest and other incidentals, or attendant features or items, and hence not meant to be treated as a limit upon any one item.

If any one item of estimate should run short, the shortage would of course be paid. And if it had been necessary to specify the amount of such item (which it

was not), the shortage would properly have fallen within the estimate of "*working capital and expenses of reorganization*" at the foot of the estimates. "Working capital" is often provided or estimated *in view* of possible under-estimates of *old* liabilities and even to pay the same.

All this is in consonance with the declared purpose at the outset to pay "*the floating debt* and existing car trust obligations," which, of course, means the *full* amount thereof.

If no provision had been made for this payment, the plan would, by virtue of said declared purpose of paying the floating debt, have *contemplated* such payment in some manner, and if not otherwise then from the income or earnings of the system or new company, as in case of any other general liability. It was certainly *not* contemplated that old stockholders should get *dividends* from the new company before such debt should be paid by it, if such a thing were fraudulent or wrong.

It was stated that "by this means"—referring to the "basis" for the reorganization, *i. e.*, "the *acquisition*" of the "*stocks* and bonds of the Suburban Belt Railroad Company"—"the *payment* of the floating debt" would "*result.*"

The absence of a specific provision for immediate payment could not be pointed to as a repudiation of the *expressed intention* to pay such debt, especially since the latter was legal and consistent with honesty and the former was not so; and hence an adequate *estimate* or provision therefor could not be construed as an intention to limit the liability or to ultimately pay but *a portion* of the debt.

But, again: While an estimate of the amount required to pay floating indebtedness was in harmony with the expressed object to pay the same, that it was not necessarily a limit upon the amount to be paid in that way is also corroborated by the provision in the agreement above referred to, that "nothing in the *plan* shall be understood *as limiting or requiring the application of specific moneys to specific purposes,*" etc.

The plan, therefore, expresses clearly an intention to pay the floating debt, and that if the plan be adopted such payment will "result therefrom," *i. e.*, from its adoption and execution.

One of the *expressed objects* of the plan was "the *payment of the floating debt.*"

For, "a result" "to be attained" is an object to be accomplished.

Now, we next observe that it was not contemplated that necessarily every share of Belt stock would be deposited in order to insure the payment of the floating debt; or that in fact a full and technically complete consolidation between the companies would produce said "result."

For it is provided that the stocks and bonds of the *Belt* Company "deposited hereunder" would be conveyed to the new company "*if sufficient are so deposited as to warrant the retention of that property by the new company.*"

"By this means"—*i. e.*, the deposit of *sufficient* (and hence not necessarily all) of said stocks, etc.—"the payment of the floating debt" would "result," or be "attained."

That a "consolidation" (not necessarily technically full and complete) would result from the deposit of "sufficient"—not necessarily all—of such stocks, etc., was assumed, since it is stated that by the same "means" and "*thereby* all three *properties* will be under one *corporate ownership,* management and control."

Right here we pause to note that the *stockholders* of the Belt Company had an interest in having its floating debt paid. When the committee had determined that "sufficient" deposits had been made, it could be said:

(1) *That deposits had been made upon the condition that the floating debt would be paid, and* (2) *hence creditors of the Belt at the moment of such "sufficient" deposit had a vested interest in the consolidation or scheme—the right to have their debts paid.*

Such, then, was the esssential purport of this plan of "reorganization, *and also consolidation,* if legally possible," of these various companies.

The Plan Was Consummated.

After the publication of the plan progress was made swiftly.

The Gulf Road was purchased by the committee, the Southern Company at once incorporated, and a deed from the master made to it March 20, 1900, and it immediately entered into possession.

The Southern continued to operate the original Gulf road, now its own, and to make an effort to keep alive the Belt organization and to continue to oper-

ate the Belt road through contract or traffic arrangements.

Some months later the Southern Company or the committee on its behalf instituted foreclosure suits against the Belt Company and its constituents as holder of the various bonds thereon, and decrees of foreclosure were finally entered in the suits (as consolidated). The property was purchased by the Southern Company, after which the latter entered into formal possession of the same.

Since then, the only relic of the Belt Company in existence has been a company without assets, without operating franchises, and without stockholders except the Southern Company (which had become a stockholder by exchange of its own stock) and the three per cent. of non-depositors. The Southern by voting its stock at corporate meetings and by other formal acts, etc., has evidently kept the Belt Company alive—or as much alive as a company can be kept under such circumstances.

It is probably best to give the whole sequence of events in the order of their

Chronology.

April 1, 1899.

"Gulf" Company defaulted in interest.

August 17, 1899.

"Reorganization agreement" of committee issued, inviting deposits of bonds and *stocks* of the "Gulf" and of both terminal companies.

September 20, 1899.

Said agreement was declared operative through a deposit of majority of bonds (or bonds and stock) of Gulf road.

November 7, 1899.

December, 1899.

Plan in force.
Plan issued.

March 19, 1900.

Kansas City Southern Railway Company incorporated.

April 1, 1900.

New officers of Belt elected, almost identical with officers of Southern.

September 6, 1900.

Cambria Steel Company takes confession of judgment against the Belt Company, and same day files creditor's bill against Belt Company and Guardian Trust Company.

September 6, 1900.

Provident Life & Trust Company files five suits (United States Court) to foreclose bonds of Belt Company and constituent companies.

September 6, 1900.

Receivers appointed for said railroad companies.

October —, 1900.

Reorganization committee settles its accounts with Southern Company.

November 6, 1901.

Decree of foreclosure of Belt road and constituents.

December 31, 1901.

Sale under such decree.

January 2, 1902.

Deed by master to Southern Company of foreclosed Belt properties.

BRIEF.

I.

Express Promise.

(I).

The plan **invited deposits** *of bonds and stocks upon the* **express condition of the payment** *of the floating debt. The decree ordered against the Southern can validly rest upon this express promise* **alone.**

1. If a plan of reorganization *involves the giving of a benefit to the old stockholders* and *nothing at all* be said about the payment of floating debt of the old concern, it is but fair to *presume an intention* to pay it—as the law will imply fairness of conduct and intent rather than fraud or injustice.

2. *All the more so* will it imply such intention where *any language* whatsoever is employed or *any clause* inserted *reasonably calculated in and of itself* to lead a depositor to believe that such is the intention.

3. The *very issue of the payment vel non* of the floating debt *was inherent in reorganization itself;* and hence such issue was squarely presented to the reorganizers in framing their written instrument *by the situation itself.*

Hence, the *slightest recognition* in language of

such debt would constitute an *express election* to pay it.

4. *The expression at the beginning of the plan of* **"the payment of the floating debt"** as *one of the* **"result to be attained,"** *i. e.,* **as one of the very objects of the entire plan or scheme,** *is controlling here, no matter what else be contained in the written plan.*

5. It is strange that in the entire brief of appellants of nearly 200 pages, this dominating and controlling clause of the plan is not discussed, if even referred to or quoted.

6. *With this clause in the document clearly expressing the payment of the floating debt as one of its* **objects,** *it is instantly seen that the plan as a whole must either be*

(1) **consistent** *in respect to this express promise feature, or* (2) **ambiguous.**

Granting *the latter for argument's sake, the dominating rules of construction will require the ambiguity to be* **resolved against the committee;** *and hence it is unnecessary to prove such consistency—and the entire issue on this appeal is thus quickly disposed of.*

7. Such plan *having invited deposits* on the basis of its broadly expressed *objects*, stockholders and creditors will not—as a *prerequisite* to recovery—be put to the immense labor of accurately explaining or construing all the complex features of the plan, and of accurately "distributing" all its facts and features, etc., in order to make it as consistent throughout as a simple promissory note, etc.

Unless a creditor's claim amounted to a small fortune he might as well abandon it as to involve himself in the expense of so doing.

——()——

Cases in point supporting this express promise claim of appellees are the following:

The Key City, 14 Wall. 653,

where the companies in the plan "of uniting their property and interests" "*recognized a large and undefined indebtedness*" on the part of the original company and on this *express* ground the succeeding company was held liable, and also as being a consolidation.

Tysen v. *Wabash R. Co.*, 15 Fed. 763,

where the expression was merely that certain bonds "shall *be protected*" by the new company, etc.

See also cases cited next *infra* under "Rules of Construction."

Rules of Construction.

(II).

a. General Rules of Construction of Contracts Applicable Here.

> "The words of a document will, in cases of doubt, be construed most strongly against *the party using them.*"

And particularly is this true in cases of deed polls.

17 Am. & Eng. Enc. of Law 14.

A construction is to be placed on a document such

as will render it *reasonable* rather than *unreasonable*, and *just* to both the parties rather than *unjust*.

Idem. 18.

> "And as being made for *legal* rather than an *illegal purpose*."

b. Such an agreement is construed strictly against the committee.

> 5 Thompson on Corporations (2d Ed.), Sec. 5993,
>
> *United Water Works Co.*, v. *Omaha & C.*, 164 N. Y. 53.
>
> *United Water Works Co.* v. *Stone*, 127 Fed. 587.

Some very pertinent language on the subject is found in *Industrial & C.* v. *Tod*, 180 N. Y. 215.

There Mr. Untermeyer successfully argued for "good faith" *both in construing and carrying out* such agreements.

On page 225 the court says:

> "As the reorganization agreement was *prepared* by *the committee* and the language used *is wholly their own*, it should be construed most favorably to the bondholders, who had no part in preparing it, but were compelled to *accept* it as it was or *not* accept it at all."

In each of the above New York cases (164 N. Y. and 180 N. Y.), in support of the proposition that a reorganization agreement will be construed strictly against the committee, the court cited the case of

> *Kratzenstein* v. *Wetsern Assurance Co.*, 116 N. Y. 54.

This case was a suit upon an insurance policy

which contained ambiguous language. (And even opposing counsel have not claimed that this plan *clearly and consistently repudiated* floating debt or was anything *less* than ambiguous.) The court there said (p. 59):

> "When an insurance contract is so drawn as to be manifestly *ambiguous*, so that reasonable and intelligent men on reading it would honestly differ as to its meaning, the doubt should be resolved against the company, *because it prepared and executed the agreement, and is responsible for the language used, and the uncertainty thereby created.* * * * If the defendant intended that the risk should not cover goods in transit, * * * *it should have said so in clear and unmistakable terms so that no one could be misled.*"

(This is substantially our argument on the point, *infra.*)

c. Contracts Implied in Fact.

If the agreement and plan did not constitute an *express* contract, *i. e., a complete* agreement to pay the floating debt, then they did constitute a contract *implied in fact* to make such payment.

15 Am. & Eng. Enc. of Law 1077-78, where it is said:

> * * * Both *express* contracts and contracts *implied in fact* are founded upon the actual agreement of the parties. The one class is proved by direct, the other by indirect evidence; in other words, the one must be proved by an actual agreement, while in the case of the other, it will be *implied* that the party *did make such agreement as under the circumstances disclosed he ought in fairness to have made.*"

In other words, if the plan made did not work

out the agreed *objects* of the parties, the committee and the Southern ought "*in fairness*" to have made *other* detailed provisions to that end.

d. New Corporation Liable Where Express or Implied Promise to pay debts of old Company.

One of the instances where a new corporation is liable for the debts of an old one is

> "where it has in *express terms or by reasonable implication* assumed the debts of the old corporation."
>
> 10 Cyc. 287 and cases cited.
>
> 23 L. R. A. 231 (citing the Tysen case *supra* and others).

e. The Word "Say" as Used in the Schedule of the Plan.

The meaning of the word "say" as used in the first item of the schedule showing the proposed application of the cash of the new company is given in the Standard Dictionary thus:

> "* * * To assume as possibly true, or as a working hypothesis; suppose; in the imperative, as equivalent to 'let us assume'; as, worth say a million."

The principle here involved is strictly analogous to that in the case of *Brawley* v. *U. S.*, 96 U. S. 168, where the construction of a contract for the sale of personal property was involved.

(III).

Estoppel.

The principle of "estoppel and election" absolutely controls this entire case. When the committee announced that one of the *objects* of the plan was the

payment of the floating debt, and the deposit of stocks, etc., *was invited upon this basis or condition*, there was a definite position taken by the committee in respect to open debts; and upon their invitation being *acted upon* by the deposit of stocks, etc., the obligation to pay became fixed.

In fact, the moment deposits had been made and accepted, and the successor company had issued its stock in lieu thereof, its liability became fixed, and it thus became unalterably committed to the payment of the debt. Even though creditors might have the election to wait until the foreclosure and possession taken thereunder—*i. e.*, until all steps in the plan had been consummated—makes no difference.

A complete *change of position* had been taken by parties interested in the payment of the floating debt (the old stockholders); and the Southern Company was thereafter estopped to deny its liability.

And the law of "quasi-estoppel and election" applies.

16 Cyc. 784-5-6.

Instead therefore of the Trust Company being estopped to claim that the plan involved a payment of floating debt, the proponents of the plan were estopped to claim that the plan *denied* such claims. And the many authorities cited by opposing counsel on quasi-estoppel, etc., apply.

———o———

The cardinal truth from all the above, be it repeated, is, that even if the plan proposed and consummated had been no more than a proposal for the Southern to become the *chief or only stockholder* of

the Belt, it *invited* stockholders to take *a step forward* and to change *their position.* It invited the old companies and all their *interests* to submit to a decided *change of status,* by which the old companies instead of being run and managed by independent stockholders became subject to the control of *another* corporation.

When such a step was invited it became imperative that representations by the moving party as to either property or debts should be *unequivocal;* and *vague or inexplicit* representations must be construed *against* it.

It is indeed fortunate that these rules of construction can be resorted to in cases involving corporations and their various stock and bond operations.

Otherwise the lawsuits that would be engendered by the *profit* in *denials* of liability *merely by putting the claimants to specific interpretation of complex documents* would speedily bring anarchy itself into the business world.

The documents made and published as a basis for the New York stock and bond market *alone* could be thus made to largely engage the labors of the bar and the courts of the entire country.

It is indeed insisted that the above citations are more than ample to support in law that which obvious justice demands.

It is therefore immaterial whether there was hidden somewhere in the body of the plan or agreement "a solemn covenant" as counsel puts it, that the

floating debt would *not* be paid; and counsel's entire argument seems to fail at this point.

But we further assert:

(IV).

There was in fact no "solemn covenant" in either the "plan" or "agreement" involved in this record, to the effect that the Trust Company would not assert its claim against the consolidation.

1. The clause claimed by counsel to be such is the one mentioned only in the agreement inviting deposits and is analyzed *supra*.

As opposed to this, and in addition to the express promise *or election*, there was here.

(a) A distinct *estimate* of the amount to be paid *as* "floating debt;"

(b) *Express authority* given the committee "to *extinguish*" floating debt;

(c) Specified amounts *expressly allowed* the committee as "working capital" and "expenses of reorganization," which may have included a portion of the floating debt; and

(d) An expression of an intention to "consolidate," a process which would be inconsistent with a repudiation of floating debt.

(e) Certain floating debts actually paid out of such "working capital" and "expenses."

2. The claim on the part of appellant that the plan was "*fraudulent*," and the whole scheme *a fraud*, and that *thereby* and *therefore* the Trust Company cannot claim its debt "with clean hands," etc., is an *affirmative issue raised by the Southern itself;* and in order to sustain it the Southern must

(a) establish the fact that the plan per se and on its face, and consistently throughout inevitably involved fraud, and in clear and unmistakable language; and (b) an actual intent and avowed purpose *on the part of the reorganizers as a band of conspirators of which the Trust Company was one,* to "freeze out" floating debt claimants.

The former (a) is absurd upon its face—*i. e.*, upon the face of the instrument; the latter (b) is also contradicted by the language of the plan, and evidence is totally lacking suggestive of such actual intent.

The Guardian having a large floating claim of its own, any such intent and purpose on its part would have been an intent and purpose to rob itself.

In charging the Trust Company of being a party to a fraudulent plan "it must be remembered that such company was only a *depositary.* In denying such character to the plan the Trust Company would be entitled to insist that the rules of *strict construction* against the committee be observed in making the test.

II.

Consolidation.

(1) *The merging or joining together of the stock and assets of the Belt and Southern Companies* constituted **a consolidation in fact** *of such companies.*

Leavenworth County v. *Ch. R. I. & Pac. Ry. Co.*, 134 U. S. 688.

Chicago, Santa Fe, etc., Ry. Co. v. *Ashling*, 160 Ill. 373.

Williamson v. *N. J. Southern R. R. Co.*, 26 N. J. Eq., 398.

Shadford v. *Detroit, etc., Ry. Co.*, 130 Mich. 300.

The exchange of stock is the distinguishing feature—the very test—of a consolidation.

Morawetz on Corp. Sec. 939.

Vol. 7 Ruling case law §§ 155-156.

3 L. R. A. 435.

23 L. R. A. 231.

7 Thomp. on Corp. (2d Ed.), Sec. 8241.

(2) There being a statute of Missouri *allowing consolidation, the Southern Company* **is estopped to deny** *that it did not observe the technical* **method** *required or furnished by statutes to accomplish the same.*

(Same cases next, *supra*, particularly the second and fourth.)

See also Vol. 7, Ruling Case Law §130.

(3) *In the face of a* **consolidation in fact**, *a creditor* of *the old concern can no more be justly put to the labor of proving the observance of various steps and methods*, etc., *legally or technically required to accomplish consolidation* and thus of "distributing facts and figures" in respect thereto, than in the instance of the express promise mentioned above.

(4) **A complete de jure consolidation under Missouri statutes** *was here affected, and a de-facto one would be sufficient for the purpose of holding the Southern liable.*

(Argued *infra.*)

(5) **The new corporation is liable:**

1st. When it is merely a "continuation" of the old (this case).

2d. When it has by "*express terms or by reasonable implication*" *assumed* the debts of the old (this case).

3d. Where it has received the assets of the old under such circumstances as to make the transaction a fraud upon the creditors.

4th. Where a statute imposes such a liability (this case).

23 L. R. A. 231.

Vol. 7, Ruling Case Law, § 156.

III.

The Opinion of the Court of Appeals.

1. The opinion of the Court of Appeals orders a recovery in favor of the Trust Company against the Southern *based upon the equities of the entire situation*, and proves exhaustively and in detail, *the equitable principles which are involved* not only as to the question of liability but also as to the *priority of lien* given the Trust Company. At the same time it answers in detail the claims in opposition.

But it is unnecessary, so far as the mere claim of liability is concerned, that the case be placed upon such many featured foundation. **The equities in favor of the Trust Company result from consolidation alone, and from the express promise in the plan.** *And to prove, as the Court of Appeals has done here so ably, that a clear equitable*

basis for full liability of the Southern exists in the circumstances, is to unnecessarily prove the merit of railroad consolidation statutes long since existing throughout the entire country. **That is, the right to recover here is not a mere equity—it is an inexorable legal right.**

The fact that old stockholders contributed money to the deal makes no difference and it has nowhere been held to affect the inexorable rule that the exchange of stock constitutes a consolidation.

The liability in every such case is a **full** *liability, and is not limited to the value of the stock or property given the old stockholders, nor to the value of the assets transferred.* Vol. 7, Ruling Case in Law, §155.

The case of *Northern Pacific Co.* v. *Boyd*, 228 U. S. 482, as many prior cases do, amply sustains the opinion of the Court of Appeals, and is squarely in point upon this ground of general equitable principles. But the case at bar is much stronger, since it rests upon the *additional* ground of an express promise. In both cases however, the creditor's claim safely rests upon the additional ground of *consolidation*—a feature apparently overlooked by counsel in the Boyd case.

2. *As to the lien feature of the opinion*:

Though the rule ordinarily may be that an "open" claim is not entitled to a first lien above the new mortgage given by the consolidation, the Court of Appeals properly did not allow such rule to control here.

For here the *express promise* to pay was a part of *carrying out the* plan; and the committee were

the agents of the bondholders for this purpose as well as of others.

Secondly, the abnormal and oppressive litigation here in evidence was instigated by the same committee which then controlled the Southern and the Belt.

And the Court of Appeals was right in making the bondholders' lien subservient to the Guardian's on this ground.

(Argued *infra.*)

IV.

The Public Interest in the Question and the Appeal of the Amici Curiae.

We here simply note that notwithstanding the great public issue in the main question here involved and the vast amount of pending reorganizations affected, no effort has been made to advance this case.

We admit the fact that great public interests *are* involved, but we believe that that interest will be advanced both in point of justice in railroad dealings and that of judicial economy in general by not only reiterating the conclusion in the Boyd case but *broadening it.*

Let it be again decreed that a plan of reorganization *inviting an exchange of stock* **involves** *liability for and an assumption of old debts,* and we will get rid of persistent efforts to make a creditor accurately distribute facts, figures, values, equities, etc., and thus detect and reveal the net value of assets transferred—as a *condition* to recover his debt. The right to recover might almost as well be denied in the first instance.

ARGUMENT.

I.

The express promise or condition in the plan in respect to payment of the floating indebtedness.

This ground of action, although distinct from the other, is, however, only fully appreciated in connection with it.

"Consolidate"—to unite, compress or pack together. * * * To cause to cohere or cleave together. Century Dictionary.

We will see below that there may be a complete consolidation of two or more railroad *companies*, or a consolidation of their *property*, operating *franchises* and *stock* (leaving the companies in technical or partial existence), or a consolidation of merely property *or* franchises *or* stock. (Either of these can be "packed together" or "united," etc.) A statute allowing such companies to consolidate "their franchises *or* property *or* stock" (which is the language of many statutes), and making the new company liable for the debts of the old, would no doubt mean a full liability for *any* such consolidation.

And we are inclined to believe that if the Missouri statutes stopped with the first and general provision of Sec. 1059 analyzed *infra*, authorizing consolidations "*in whole or in the main*" and prescribing full

liability upon the absorbent company, etc., every arrangement by which merely the *stock* of one company was held or purchased or exchanged for that of another would hold the receiving company for full liability for the other's debts.

For stock or stock interests can be "consolidated," "united" or "packed together."

So a right or privilege to operate a railroad from A to B can be "added" or "joined" to or "united" with a right or privilege to operate a railroad from B to C and the result is a consolidation of operating "franchises."

So one railroad property or equipment can be added to and mixed with another such property or equipment, and the result is a consolidation of railroad "property."

Now, whether the new company should *on principle* and apart from any statute be held to liability where there is only an exchange or purchase of the major portion of the stock of the old *and no mixing of property* is not absolutely or instantly clear. There are potent reasons to support the affirmative.

In such case the old corporation still exists; it may still be managed, but not as an independent corporation controlled directly by individuals and they thus having control of its assets, but as controlled by individuals *through the medium of another corporation.* The old corporation *has lost its identity* as an *independent* dealer and has gone into *quasi* partnership with another corporation. In such case it is or it is "in the main" a member of a combination—before it was an independent body. Rather, it has been

partially dismembered, and the larger part of its substance absorbed by the other corporation. One could momentarily view this transformation as leaving a part of the original corpus in its original state, which part would be represented by the individual stockholders not joining in the merger. But a corporation is not sectionized in its composition, stockholder by stockholder, nor are its assets divisible into units, each unit corresponding with each stockholder's interest. It will be a far more accurate view to consider the change as a partial metamorphosis of the old company, by which, while some of its elements are left undisturbed, its acting power and speaking voice are controlled by the absorbing corporation, or rather merged in it. The corporation's identity as an *independent actor* has been lost.

Certain it is that the joinder of such stock interests is *apt* to unsettle or change the interests of stockholders as held in each company prior to such coalition.

This is obvious. It is *possible* for the one company to be dominated or contrtolled in the interest of the other and to the prejudice of minority stockholders in the one; and *possible* for both companies to be managed in a way prejudicial to the public right to fair rates, etc., or, as some would put it, to its interest in "competition." And hence a line of cases like the Pearsall case, 161 U. S., 687, and the Northern Securities case, 193 U. S., 197.

While, however, such a coalition would give such an opportunity for *oppression*, etc., it would also possibly give an opportunity for *benefitting* all stockholders and public alike,—providing there was

a wise and salutary conduct of both enterprises and faithful consideration for the rights of all parties. And this would be possible without making necessary in all cases the complete merging of franchises, property, or stock, of the corporations themselves.

Hence, in the gradually intensifying of modern commercial industries, many statutes have been passed (like those in Missouri) allowing, in addition to actual consolidations, one company "to purchase and hold" the stock of another and vote such stock and to "acquire" such stock or "to subscribe" for such stock "in aid," etc., where the other company *continues* to "use and operate" its *own* property or road.

Under these statutes it had been held therefore that where one company thus has acquired the stock of another, or the major portion thereof, and the latter company *is kept in control of its own property* and operated in the same manner as if it had a full set of individual stockholders, etc.—then there is no liability on the part of the purchasing company for the other's debts. *Pullman, etc., Co.* v. *Mo. Pacif. Ry. Co.*, 115 U. S. 587.

But it is also true where the property or assets are mixed the holding company is clearly liable. (Cases *supra* in brief, Point II.)

It is obvious that where one corporation owns all or substantially *all* the stock of another, there is *usually* but little object in keeping the properties entirely separate and operated separately; and it is even hard to do for any length of time, except in the case of very large corporations. There could be little hardship in holding the purchasing company

for the debts of the other in any case; for the latter would have the sole interest in the property.

The point for the present is, however, that the purchasing company must in such case **affirmatively keep the assets separate and keep the purchased company going as an independent organization** *in direct control and management of its own property. If it allows the one organization to lapse or the properties to become* **mixed a direct liability will follow.**

The direct interest in, if not direct control of a corporation's business and assets, possessed by a sole owner of its stock, has quite naturally given rise to many attempts to hold such stock owner directly liable for the company's debts. In Maryland the courts have gone so far as to hold him liable—a rule opposed to the weight of authority.

Now, while we concede that in such a case the holder of all or substantially all the stock of a corporation, whether an individual or a corporation, is not by reason of that fact *alone* liable for the corporate debts, yet we point out that it would require but a *slight recognition* on the part of a purchasing company of its liability in order to fix the same upon it.

And where stock of the old company *is bid* for by the new company and on the basis of an exchange of its own stock therefor a statement that one of the "*results*" or *objects* to be "*thereby attained*" was "*the payment of the floating debt*" of the old company would be ample in and of itself, *without considering* questions of a *subsequent mixture of assets*

of the two companies or the taking possession of the old company's assets by the new one.

———o———

In the case of *The Key City*, 14 Wall., 653, one Young shipped a quantity of wheat by the "Key City," which vessel was owned by the Northwestern Packet Company. The cargo was lost.

At this time there was a rival steamboat corporation known as the La Crosse and Minnesota Steam Packet Company. After the loss of the wheat these two companies "united their stock in trade, their steamboats, barges and other property, and formed a new corporation, the corporators of which were taken exclusively from those in the two old companies; and to the new corporation they gave the name of "the Northwestern *Union* Packet Company."

It appeared that the original Northwestern Company "was largely indebted and provision was made for the payment of the debts generally of that company by the newly formed company and of a fund to come within its control. The nature of that provision was this: Certificates of stock of the value of the boats, barges, and other property of the Northwestern Company merged in the new company were issued, but on their face they recited that *no dividends would be paid* on such stock *until the debts* of the Northwestern Company *should be paid* out of the proportion of the net profits which the shareholders of that company would otherwise be entitled to."

In this state of things, Young, three and a half years after the wheat was lost, and his cause of

action had accrued, filed a libel in admiralty against the Key City for its failure to perform its contract of affreightment. The new corporation appeared and contested and the lower court dismissed the libel. Young appealed. This court reversed the decree.

The court, through the renowned MILLER, said:

> "We are of opinion that if the claimants" (the Union Company) "had shown an ordinary case of purchase and payment without notice, the lapse of time would protect them."
>
> But "these" (the circumstances attending the transfer) "show that there was *no sale* of the property of one of these original corporations to the other, but that they agreed to unite their *property* and their *interest*, and for convenience assumed a new corporate name; that in doing this *they recognized a large and undefined indebtedness* on the part of the (original) Northwestern Company, and *provided* for its payment out of the earnings otherwise payable to that company."

It was therefore held that, on account of this *recognition*, there was no sale and purchase for value, and upon the *additional* ground that there was "a consolidation" of the two old companies.

Note how similar to the provision as to debts in the present plan is the one in the Key City case.

"Whenever *it appears* from an instrument, *notwithstanding its form* that *it is intended to afford a security*, an equitable lien exists in favor of the person in whose behalf the provision is made."

Tysen v. *Wabash R. Co.*, 15 Fed. 763.

Apply this principle to the present case, thus:

"Whenever *it appears* from an instrument, *not-*

withstanding its form, that *it is intended to pay a debt*, an action exists in favor of the person in whose favor the provision is made."

"In the articles of consolidation one of the bases and *conditions*" thereof was stated to be, as to all the bonds, that they "shall as to the principal and interest thereon, as the same shall respectively fall due, *be protected*" by the new company. Held, that not only was the new company liable, for the bonds, but that the lien thereof was *expressly* preserved by the instrument of consolidation. *Idem.*

These two cases are in point, and amply support plaintiff in its claim of an express assumption in the plan of the Belt floating debt.

It was not necessary that the phrasing in the plan should be as specific and clear as that of a promissory note or an ordinary contract to pay—where *no property or interests therein* are involved.

Creditors, whatever their legal rights, *had a vital interest in the assets to be transferred*, and the question whether they were or were not to be paid was directly presented.

It was an issue fully presented by the situation itself.

Therefore, very little in the way of an express recognition of such debt was sufficient to show an election to pay the same.

Where one class of persons interested—stockholders—whose claims in the assets to be transferred were *inferior or junior* to another class,—creditors—were to be given a specific interest in the new prop-

erty consisting of the old assets joined to the new, the question was squarely presented to the parties furthering the scheme: *what is to become of the claims of creditors in this property or trust fund which you propose to mix with the new?*

When it is answered, that "*the* **payment** *of such claims is one of the* **results** *to be attained,*" is *this* not sufficient to show an election in regard thereto? What more is necessary?

Would this not be enough to dominate the election of a creditor who was contemplating a suit to follow the assets of one of the old companies? And if so, is it not an *express election* on the part of the contracting parties to *pay him?*

———o———

The more this feature of the case is studied, the more clear and inexorable the conclusion that the point here made is sound and controlling.

After it is broadly stated as an *inducement* for stock deposits, etc., that "*one of the* **results** *to be* **attained**" "is the **payment** *of the* **floating debt,**" what concern need the depositor or creditor have with the *details* in respect thereto? That is: What show of justice can there be in requiring a stockholder who is also a creditor, or one who is a creditor merely, to work out all the details of the many featured and complex plan of these complex organizations, and to work them out *accurately, or else to lose his debt?*

What burden is cast upon *him* to actively see that the "object" or "result" of the plan is carried out in full?

An immense lawsuit could thus be forced upon any depositor and any creditor (for every stockholder is presumably *interested on behalf of all* creditors) in every case of a reorganization agreement—as, for instance, such a lawsuit as is measured by the arguments of able counsel in this case *even since it has reached this court*—to say nothing of the prior litigation of many years. What protection would the public have if this is made possible under the law?

1. If *nothing* be said in such a plan *about payment* of a floating debt, it is fair to *presume an intention* to pay it—and particularly where *stockholders* are clearly to receive a benefit—as the law would imply fairness of conduct and intent rather than fraud or injustice.

2. *All the more so* will it imply such intention wherever *language is expressed reasonably calculated* in and *of itself to lead a depositor to believe such is the intention.*

The object of the plan is broader than the details thereof.

And even if it *were* clear from the *details* of the plan that the expressed object (payment of the floating debt) would *not* be fully subserved thereby, would not a party dealing with the plan or its proponents be warranted in believing that the plan would be *changed* to conform to its *expressed objects?*

So that whether we approach these words from the standpoint of "strict construction," "election and estoppel," "contract implied from the language *and* circumstances," each of which as shown above

technically and fully sustains the claim, etc., the appeal of the creditor to be relieved of the responsibility and burden of *accurately distributing all facts, features and figures* of the complex plan *as a prerequisite to collect his debt* is too just and too inexorable to go unheeded.

So that even if the plan had clearly and by its other express provisions **contemplated merely** the **acquirement, or out-and-out purchase of the stock of the old companies by the Southern, this one clause would hold the latter to the payment of the floating debt.**

And why? Because it invited a *change of position* on the part of stockholders of the old companies,—corporate functionaries of such companies interested in seeing such *debts paid.* It invited the taking of a *step forward*—a change from individual stockholders to one corporate stockholder and the *partial merging* of corporate interests theretofore absolutely independent.

A fortiori will such payment be conclusively inferred when stockholders of the old companies are expressly given *an interest* in the new arrangement.

And this case can therefore be properly ended at the *beginning* of the plan, at the point of its *expressed objects*—instead of at the end. And this is our excuse for submitting this document.

II.

Consolidation.

(I.)

Several Much Neglected Principles.

The course of American decisions on railroad reorganizations contains indeed a big lesson for the American bar. In particular, it illustrates what a vast tribute in the way of misconception, crude work and hence loss we pay to our modern twin evils so to call them—complexity and haste.

In such haste have we been as a profession at large to do things quickly and reach financial and "practical" results in the instant situation, that we have been prone to take an issue up at the point of the last favorable decision. Thus the chain of decisions grows and lengthens, until it becomes so long that the new student does not stop to analyze, but assumes that the principles or methods heretofore announced must of necessity be exhaustive and that of necessity all features of the subject have naturally been covered by the labors of the prominent lawyers who have delved in the same field.

To come to the specific:

1st. In the leading case of *Railroad* v. *Howard*, in 7 Wall.—74 U. S. 392—decided in 1868, certain creditors of the old corporation successfully levied in equity upon the particular quota of stock of the new company which was about to be delivered to stockholders in the old company. This court held that the rights of such creditors in the assets of the old

company were superior to those of the stockholders and allowed the creditors to levy upon that which represented in the new form exactly the fund originally liable for such debts or at least the *quantum in value* which had been wrongfully preferred.

What has been neglected about this now famous decision is the fact that the court was merely announcing a result of *one* out of several *elective* remedies of such creditors, and its express intimation that such creditors *could* have elected to sue the new corporation *at law*.

For the next 20 years or more, quite a few cases arose of two additional general classes, viz.:

2d. A number like *Montgomery-Webb Co.* v. *Dienelt*, 133 Pa. St. 585, where it was ruled that transfers of property from the old to the new company where old stockholders share in the fruits of the deal, as it were, were "voidable" as against creditors of the old concern, and that the *property* transferred would still be treated as a "*trust fund*" which "*equity would follow* on behalf of such creditors, for satisfaction of their debts."

3d. Cases like *Railroad* v. *Ashling*, 160 Ill. 373, where they held that in similar circumstances the new company would be *liable at law* for the *full* amount of the claims *independently* of and without reference to the *value* of the property transferred.

This last class of cases has been too little emphasized. The very principle embodied in them is the one which has occasioned the passage of the laws of the various states providing for full liability on the part of the new company for the debts of the old *whenever* a consolidation is made.

4th. Then came the ruling in *Louisville Trust Co.* v. *Louisville & N. R. R. Co.*, 174 U. S. 674,—the "Monon" case—where it was held that the fact that a reorganization plan *failed to make provision* for the payment of existing debts, *plus an actual and fully proven intent not to pay them*, would give ground for a creditor to *interfere* and *frustrate the plan*, at least to the extent of stopping a foreclosure suit against the property *until* such question could be fully inquired into and the creditor equitably treated or provided for.

In later years, in many cases the railroad financiers seeking to bar out old creditors, have tried to complicate the situation by (1) having the old stockholders put "fresh money" into the deal and then claiming (2) that, reckoning lien debts and the "fresh money" together, there was *nothing left* "of value" for the open creditors. Sometimes and usually, as here, a foreclosure was used and the forced sale value pointed to as conclusive evidence of the value of the property and as the means of demonstration that there "was no equity" for the general creditors.

Some encouragement was given to this plan by the now fully rejected ruling of Judge Jenkins in *Paton* v. *Chicago & North Pacific R. R. Co.*, 85 Fed. 838, and several other lower court rulings; and also by some slight references in the dissenting opinion of Mr. Justice Lurton in the late Boyd case.

And some encouragement may also be gathered from the qualifying words of the opinion of Judge Munger, and of the second and *per curiam* opinion in the present case that in similar circumstances

the new company is liable for the old debts "*at least to the extent of the value of the property* taken and converted, * * * or secured by the stockholders of the old company," etc.

These qualifying words are potent with the greatest imaginable injustice.

The particular service to the court and the profession upon this general subject which we attempt here—with hands all too crude and unskillful—is to prove the following:

1st. *That in no case of an exchange of stock* is the liability of the new company limited to the value of the new stock turned over to the old stockholders, *nor is it even limited to the value* of the *property turned over to the new company.*

That by the **very act** *of the* **exchange of stock** *the new company* **assumes** *to pay the debts of the old and the debts* **in full.**

That is, that the *act* of exchanging stock and acquiring the *assets and business* of the old company **implies** the assumption of old company debts.

3d. The UTTER LACK OF EQUITY *in* REQUIRING *a creditor* TO **follow** *the complicated and many featured property of a* **railroad** *corporation and prove the value or amount of this "trust fund," as a prerequisite of collecting his claim.*

If the claim were for a large amount, a huge fraction of the claim would be eaten up by the expense of the contest; if a small amount, it would be entirely consumed.

The *fact* of such injustice was no doubt the *chief reason* impelling the passage of statutes casting *full* liability upon the consolidation.

The author of a very luminous review in Vol. 7, Ruling Case Law, § 155, says that "the qualification *at least to the extent of* 'the property received from the old corporation' seems to have been employed from an abundance of caution, and is not referred to in the great majority of cases."

So, too, the counsel for Boyd in the late case (228 U. S. 482) used these qualifying words in presenting his claim.

We are therefore satisfied that had this issue been fully presented to the Court of Appeals, it would have disposed of the entire case upon *the fact alone* that *the reorganization plan here invited the exchange of old stock for new.*

———o———

Another thing that strikes the student of railroad reorganization cases is the prevalent tendency of counsel attacking reorganizations or seeking to establish claims against the new company to raise the cry of "fraud."

Some cases reveal plans which in their essence were violative of the rights of unsecured creditors and constructively fraudulent.

Other cases—but not so many, involving constructive fraud in the plan of arrangement, revealed also *actual* fraud—a well-defined and well-proven *intent* upon the part of the acting parties to defraud general creditors. As in cases of constructive fraud, the law imputes to each one concerned therein a knowledge of the consequences of his acts—there are few cases where proof of the actual intent to defraud was of any particular consequence—except

ing where some gross waste or concealment of assets, etc., was incidentally involved.

Then there are cases where the payment of the floating debt of the old companies involved *was provided* for in the plan itself, but was *repudiated* by the new company or the parties controlling the consummation of the plan.

These latter cases were not technically cases of fraud. *They involved merely a breach of contract.*

A man may have a fraudulent intent in breaking a contract. But this ordinarily is immaterial. No matter what his intent, his contract is broken, and the measure of damages for the breach ordinarily is the same, no matter what the intent may have been. The party at fault might have known that he was at fault, or he might have believed that he had a legal right to do the act which constituted the breach.

Are plans of reorganization *which do not expressly provide* for floating debts necessarily *actually* fraudulent? Or, rather, do the parties furthering such plans *necessarily* intend fraud? Why not say that it may have been an oversight and attribute good motives instead of bad ones to the parties interested? Or, why not say that as the scheme to be valid *involved* the payment of floating debts that it must have been *intended* to pay them? Why not say that as a plan of reorganization by which stockholders of the old company are to have an interest in the new, is not necessarily illegal or fraudulent, unless the *positive intention not to take care of creditors clearly appears* as a proven *fact*, it will be *presumed* that the latter were to be protected.

Why not say that if such scheme *implies* such payment, the new purchaser will be held in *implied assumpsit*, and will not be allowed to say that the plan was meant to be fraudulent?

Why then relegate the debtor in such cases to the remedy of *frustrating* the plan, or pursuing the old assets, or otherwise being barred from recovery?

If general creditors ought to be paid in such case, does it lie in the mouths of those effecting the change to say that *they meant to defraud?* Could not the parties affected—the creditors—say, "We will concede or assume that your motives were honest, and that you *either* inadvertently omitted to mention or provide for the floating debt, *or* you and your colleagues recognized all around that the law would cast the obligation upon you? Can we not elect to consider your scheme *an honest* instead of *a dishonest* one?"

And, while creditors might in such case *intervene* and stay proceedings until their rights were provided for, we repeat that the liability *being implied from the step taken*, and thus fastened upon the new company, it was, like any other liability, a claim at law, and would continue until barred by limitations.

In the leading "fraud" case, *supra, Louisville Trust Co.* v. *Louisville & N. R. R. Co.*, 174 U. S. 674, —the court expressly excuses earlier action on the part of the attacking parties on the express ground that they were warranted in attributing an honest intention to the part of the reorganizers until the contrary clearly appeared from the facts.

And even if actual fraud **has** *entered into the*

deal, why can the creditors not waive the fraud and sue as in any other case of breach of trust?

In the leading case of *R. R.* v. *Howard*, 7 Wall., *supra*, the creditors intervened before the deal was entirely consummated. The arrangement provided that stockholders in the old company should receive 16 per cent. of the stock in the new. Just before the stock was delivered to the old stockholders the creditors had it sequestered and appropriated to their claims. Something which represented exactly *the value of that taken* from the old company which had been subject to the payment of its debts was thus seized upon, and in a case where it was clear that the parties *meant* to consummate an actual fraud. But the one thing about this Howard case which has largely escaped the notice of the profession is this: That *if* such creditors had *not* intervened they *could have sued the new company direct for their claims* and *recovered* the full amount thereof.

If the creditors in this Howard case had failed to intervene, or had not taken prompt steps to levy on the *identical stock* thus appropriated, they would have been barred therefrom, as the stock would have been apt to pass into innocent hands. *But the* **right of action** *against the new company was a* **distinct** *right* and would remain unaffected.

And the court *distinctly held that the fact* that the creditors *had* a remedy at law against the new company (if they *elected* to sue it) was immaterial.

One vital proposition, therefore, is:

Any such arrangement, whether called a consolidation or reorganization, by which the stockholders of

the old corporations reserve a value in the property, is fraudulent and void in law as against creditors, unless the claims of such creditors are provided for, or it is intended to pay them.

But a *corollary to this proposition is equally important to be borne in mind, viz:*

Any such *arrangement whereby the property of the old company and the new—the two trust funds—are joined or merged in consideration of the exchange of stock* **implies** *the payment of the claims for whose benefit they are held, and of necessity carries with it that liability.*

And this *independently* of a statute fixing the liability.

7 Thomp., Sec. 8241.
23 L. R. A., p. 231.
3 L. R. A. 435.

3. The *third* feature of reorganization law which we submit can stand more elucidation and emphasis is that which relates to the *election of remedies* and the *effect of foreclosure* in certain cases.

The very fact that there is confusion on a subject so vital as railroad reorganizations and of such universal and overwhelming public interest, drives us back to the very threshold of the entire railroad subject in all its originality, its ultimate, and its ideal, if you please.

Railroads are a species of public highway, a public convenience—inexorably demanded by modern conditions. Primarily, it is the duty of the state to provide public ways for traffic conveniences. Many states originally built and operated railroads. In

some European countries to-day the government owns and directly operates railroads, in some the government owns and private companies operate them.

The fact that the state licenses private capital to establish and operate railroads makes them no less public in their essential character. Moneys contributed, therefore, to the establishment or operation of railroads are contributed directly to a public use—to the state.

The idea of repudiation of any of such claims is unnatural. The state should pay its debts, and the idea of repudiation of public or state debts, we repeat, is intolerable.

Is there, then any comparative merit in claims against the state as respects *the establishment* of highways and the *operation* thereof?

Operation presents the more immediate necessity, and it would seem that as between the two claims, moneys furnished to a going railroad system, *i. e.*, to keep it going, would have a natural preference over those contributed for the establishment thereof,—a principle recognized in the instances of preference allowed by the courts for supplies furnished for a period immediately prior to insolvency or foreclosure, and also by the issuance of receiver's certificates, etc.

Hence, we find that in England, where roads are still privately owned, the railroad system has been modeled upon the plan of avoiding the waste and delay, etc., of foreclosure, and at the same time recognizing the *exacting equities* of open debt claims. And under the acts of parliament the Railroad Com-

mission there, as stated elsewhere herein, has power to force a reorganization, even as against the consent of stockholders, and allow a scaling down of bonds and interest as well as stock—with ordinarily a payment *in full* of floating debt.

This system also effects a saving of public moneys by the very means of the security or grade of merit thus afforded to "open" or "floating" claims, namely, by lowering the rate of interest demanded, which inevitably follows an increase of security, viz: by way of a preferential classification.

It is at this point where we wish to observe that the dissenting opinion in the Boyd case is in its strongest aspects *a protest against our system of allowing foreclosure of public railroads*,—which always entails loss and unnecessary expense. *It is an appeal for a system better fitted to the situation* and industry.

———o———

It seems that counsel in presenting the late Boyd case (228 U. S. 482) to this court failed to recognize the wide divergence between cases where the creditor *seeks to pursue the property* of the original company and where he elects to sue upon the basis of the *consolidation* of the companies.

It is in fact marvelous that the claim of the complainant Boyd was not rested in the alternative at least, upon the basis of a consolidation; for there *was there an exchange of stock.*

And we do submit that it is now settled and axiomatic law that "the *exchange of stock* is the distinguishing feature of a consolidation." (Authorities *infra* and *supra* in brief Point II.)

If this be so, it is so absolutely and *independently of any contributions of money made by stockholders.* It is none the less a consolidation by reason of contributions of money made by them or any one else, or of obligations undertaken by them—which are usually the equivalent of money, etc., etc.

Had the case been squarely presented to this court on the basis of *a consolidation* it would no doubt have been instantly disposed of upon that issue, and in the affirmative—unless an overwhelming list of consistent authorities were to be overruled.
The court, however, would then have reached a more doubtful question as to whether or not, in addition to finding a legal liability on the part of the consolidation to pay, the court should give, as it did, a *special lien upon the old assets.*

There is at least authority to the effect that in ordinary cases the liability of the consolidation to pay is a mere general liability with no special claims on the part of the creditor to a lien over the new mortgage indebtedness.

The chief finding of the majority opinion in the Boyd case is a *liability to pay,* there being no serious question assumed as to the *special lien* given by the lower court.

The dissenting opinion protests against an open creditor having a right in effect to *stop a foreclosure* where evidently there is nothing of value in the property to pay the debts after foreclosure. That is, it assumes, as we think in error, that if Boyd could not have *stopped the foreclosure,* he could *not recover at all.*

As held in the majority opinion, as well as in that

of the Court of Appeals herein, *the value at the time of reorganization* is not conclusive evidence of what the *value might be at the end of a foreclosure.* And hence there lurks in the dissent a fallacy, as we submit, at this point.

But this argument or protest against an adversary foreclosure of a public utility system when there is apparently no value above the mortgage, *is a loud and unerring appeal for a change in our entire railroad system,* one that will avoid foreclosure as a totally unnecessary expense and as generally *unfitted* to such industry or system.

In other words, all this brings us to a parting of the ways in the matter of railroad finance, and it is high time for America to pattern her system in this respect after the English and other European systems and keep step with railroad progress.

But the injustice which lurks in the dissent lies in the fact that, while in some cases, as in the instance of the Northern Pacific, a bond indebtedness and interest thereon may have become so great and the entire system so reduced in earning power as to show a great deficiency in value,—and hence the apparent uselessness of foreclosure,—nevertheless under our established system *credit is not given to the company upon that basis;* nor on the basis of a waiver of the right to insist upon foreclosure or be concluded in the contingency that the reorganizing officials (the debtor itself) should (a) find the value and (2) should find as a fact that there was "no equity." Nor is such credit given upon the basis of a *stockholders'* foreclosure, one instituted at the instance of the mortgagee.

Most of the dissenting opinion can be used as a sound argument against Boyd's right to *stop the foreclosure* as fraudulent *per se*, and as a colorable argument to deny that he is entitled to a *specific* lien; but it could not be used *at all* against the assertion of a *general liability* of the new company arising by virtue of *consolidation statutes*. And the reasoning of the dissent leaves this proposition of general liability unattacked as clearly as the majority opinion—for lack of a full presentation of the case as we see it—fails to fully emphasize it.

The expression in the Boyd case as to "a non-assenting creditor" being "offered a fair share" in the reorganization plans and the right of a court to bind a creditor "not accepting fair terms offered" *where he seeks to subject the property* of the old company to the payment of his debt, etc., is pregnant with great misunderstanding and accounts in our judgment largely for the divergence of views of the justices of this court in that case.

The Boyd case was evidently presented to this court in a way that ignored the *election of remedies* which an "open claim" creditor had in the circumstances.

A creditor's claim of a right *in equity* to *forestall or block a foreclosure* is *one thing*.

A creditor's claim of a general "common law" or *legal liability* upon the purchasing or succeeding *company* is another thing and an entirely different thing.

As to the former, it is said in what is frequently called the "Monon" case (*Louisville Trust Co.* v.

L. & N. R. R. Co., 174 U. S., *supra*) that he can block such procedure when he asserts *actual* fraud—a proven *intent* to wrongfully exclude him in the entire scheme of reorganization of which the foreclosure is a part.

Such a holding *may* go "to the edge of the law," as Mr. Justice Lurton remarks in his dissent; but this *may be* because it goes to the edge of the *necessity* to protect the open creditor.

It is one thing to intervene and *stop the foreclosure* of a great big public utility system which may be suffering from bankruptcy and in the public interest should be quickly restored as a financially "going" concern.

Nothing short of a clear showing of *actual intended fraud* as in the "Monon" case should warrant success in the effort. And hence, the applicant coming into *equity* can be conditioned by the fact of such overwhelming public interest and be barred from *interference* or from *following the old assets* by even slight laches or possibly "failure to *accept fair terms offered.*"

But the very considerations of overwhelming public interest in the enterprise and the necessity of keeping it "going" without undue hindrance to those responsible for its operation and seeking to rehabilitate the property and at the same time to keep the service at its best and improve it right along to the best advantage, etc., etc., *heighten the merit of the creditors claims and make more urgent the duty to take care of them.*

The overwhelming necessity of keeping a public

utility "a' going" bids for extra confidence on the part of lenders of money, that moneys furnished for *such urgent purpose* shall *not* be *imperiled,* and that claims for furnishing supplies, etc., shall be ever treated as above and far above the stockholders' claims—*i. e.,* the *money-making* claims.

It is this very principle which supports the preference which courts give to claims contracted a few months or so prior to foreclosure and insolvency—making them a lien even above prior bond issues.

If these claims of open creditors of a public utility are or should be recognized as of special merit, such claims would always have *a special power or advantage*—over open claims against a "private" or ordinary corporation—in conditioning a foreclosure. That is to say, a court of equity would or should give such claims a *special opportunity* to attempt to save the foreclosure and the fullest opportunity to raise the interest due and thus to defer the foreclosure—and probably save it.

The value of the creditors' right or interest "in preventing the foreclosure, or for the purpose of conditioning the foreclosure, or for the purpose of the present or future control of the property," referred to by the Court of Appeals in its second or *per curiam* opinion is not merely a right *to obstruct; it is a strict legal right to demand* **"an adversary** *foreclosure,"* if any at all is to be had. In which case the creditor would have opportunity to appeal to the court for delay with a chance to profit from possible bettering *of trade* conditions, as well as being entitled to presume, as he did when he loaned his money, that the stockholders and their interests—the very *corpus*

of the legal person liable for the debt—were behind his claim in seeking to save foreclosure.

Furthermore, no matter what public inconvenience may be given to efforts, well intentioned or otherwise, on the part of the railroad financiers, stockholders and bondholders, to speedily bring about a rehabilitation, etc., by a creditor enforcing his *right* to delay, if we may call it such, *that right was in part at least the fundamental consideration or inducement for giving the credit.*

———o———

Should open creditors of the prior company be given a first or prior lien upon the road or property of the consolidation.

1. There are texts and decisions in the negative, and it is held that the lien of the new mortgage is not affected by such claims.

Where however—as in the case at bar—the organization plan itself *expressly provides* that upon or by the *consummation of the plan itself* such debts will be paid a *distinctly different* situation and issue is presented.

The reorganization committee is the agent of the old stockholders of the old bondholders and of the new stockholders and *bondholders.* And where the plan contains such express promise of actual payment of such debts, and a creditor is thus invited to *suspend the use of a remedy* against the *property* of the old company, to put his claim *behind* the new bondholders, does not equitably satisfy the situation.

The original lien against the original property (*i. e.,* the old mortgage) being released a judgment

against that company for an open debt would become a first lien.

And where the parties so releasing their bonds *become parties* to an express promise to pay the debt *upon* release of their bonds, they can not equitably complain of the lien being fastened upon such property in consequence of *their* default.

The decree ordered by the Court of Appeals is well based not only as to its holding of liability, but also as to the special lien given to the Trust Company's claim as "prior in time and superior in equity."

2. *But there is another basis for the giving of this first lien to the Trust Company, viz.:*

The fact that at the time of the filing of the bills of complaint herein the Reorganization Committee was in control of the Belt Company and the Southern Company; and hence the very *agents* of these new (and old) bondholders WERE RESPONSIBLE FOR THIS OUTRAGEOUS LITIGATION AND THIS EXCEPTIONAL AND ABNORMAL BURDEN CAST UPON THE TRUST COMPANY AND THE OPPRESSIVE TACTICS USED TO DELAY IT IN COLLECTING ITS CLAIMS. Claims, too, proven by the books of the Belt (the Southern) itself, by exchange of accounts, by *notes* and *extensions* of notes, and in every conceivable way ordinarily used to settle accounts and foreclose any question of them.

(II.)

The Nature of a Corporation.

Morawetz says (2d Ed.), Sec. 780, that at law "a corporation is recognized as an entity without regard to its membership." "In equity a corpora-

tion is recognized as an association of individuals united for their common benefit under a collective name."

The idea of regarding the corporation as a thing or person apart from its members, as it is said, "is a mere fiction."

That is to say, the corporation is a mere *contract* of membership.

Corporations "act" and it is said, therefore, that they are persons—artificial persons. But articles of association or contracts cannot act in fact; it is the members who, as officers and agents, do the acts. Therefore, as Morawetz says, the view of a corporation as a person or agency apart from its members is a mere fiction.

Corporations owe duties, or their members, *as part* of the corporation, owe duties *arising from the contract of membership*, to be performed *together* or in certain specified ways. By such contract these duties are chiefly thrown by the stockholders upon the directors and officers. But all three classes are component parts or factors of a going corporation, and stockholders themselves have some active and positive duties. What their liability is for a breach of these, or what penalties they pay therefor, whether great or small, is a different matter.

The corporation as such *owes*, and hence all its component members and agents *together* owe, a duty to the state, a duty to its creditors and others dealing with it; and its members each owe a duty to the corporation as such or to each other as members thereof.

A corporation just starting in business bids for

credit upon the faith of its capital, as it is frequently stated. But, in reality, this it not all. It bids upon the strength of its capital *and* upon the implied promise that its capital shall be *actively used* and managed in the line of corporate purposes and for the purpose of being *increased,* and also that this management and use shall be continued *for the full life of the corporation.*

It is true that the creditor cannot actively compel the continuance of the corporation in case its directors decide at any time that it shall quit business. But that does not alter the truth of the fact just stated.

It is frequently stated that the assets of a corporation constitute a trust fund for the payment of its debts; and that its debts must be first paid before its stockholders (in reality the corporation itself) get any portion of or benefit from its assets. The control of these assets rests with the corporation or its officers and agents, they being required to manage and handle the assets in good faith towards preserving and increasing them and in the interest of the creditors as well as the stockholders.

If a corporation actively ceases business, its creditors have a right to have its assets sold and the proceeds applied to the payment of their debts.

The state in such cases has a right to have the franchise forfeited or surrendered up, and to have the existence of the corporation formally ended.

Yet the rights of creditors are, of course, clearly independent of and distinct from those of the state; and a corporation which has actively ceased business and has had its assets entirely distributed may still

exist as a corporation, or a legal *corpus* for the settlement of creditors' claims, etc.

In other words, as long as there are *some* contract rights or privileges *to be adjusted,* the corporation,—*i. e.,* the contract—is treated as being in existence *for such purposes.*

(III.)

What Constitutes a Consolidation of Corporations?

One starting out to study this subject from the books will soon see that the courts have wrestled hard with the definition of the term "consolidation."

In England the corresponding term is "amalgamation." One of its learned justices declared "it is difficult to say just what the term 'amalgamation' means." (Page-Wood, V. C. See Brice, *Ultra Vires,* 2nd Ed., p. 708.)

"The term 'amalgamation' has no definite or positive signification. It is employed more or less loosely to denote various operations, in themselves widely different, which more or less completely work a transfer of corporate affairs from one corporation to another, and a merger of the former body in to the latter." (Brice, p. 708.)

It is very evident, then, that, as is usual in such cases, the term has a wide range of meaning or is generic in its nature, and logically divides into several specific classes.

The trouble is, as is usual in corporation cases, the rights involved or to be affected in the various

cases have been so different that the struggle over the definition has been had with but little profit.

A joinder of interests of several corporations might be so far effected in one case as to effect certain rights in a certain way, and yet not affect certain other rights. As to what effect it did have in the particular case considered depended upon what had been done.

"*Consolidate—To unite, compress or pack together and form into a more compact mass, body or system.*" "*To cause to cohere or cleave together.*" "*To bring together and unite firmly into one mass or body.*" Century Dictionary.

"Reorganizations" of railroad properties are generally classified as either consolidations or reorganizations *proper*. The two are defined in the Encyc., 2d Ed., Vol. VI, p. 801, thus:

> "A CONSOLIDATION occurs where the *rights, franchises and effects* of two or more corporations are by legal agreement combined into one whole and committed to a single corporation, the stockholders of which are composed of those (*so far as they choose to become such*) of the corporation thus agreeing, whether such single corporation, called a consolidated corporation, be a *new* one then created or one of the original corporations continued in existence with larger rights, capacities and powers."
>
> "REORGANIZATION is to be distinguished from consolidation. The former term is used to designate the formation of an entirely new and distinct corporation for the purpose of *purchasing* the property of another corporation and superseding it in its business, *without incurring any liability* to the creditors of the latter."

The *exchange of stock* is the distinguishing feature of a consolidation.

This is *settled* law.

Morawetz, Sec. 939.
Vol. 7, Ruling Case Law.
3 L. R. A. 435.
7 Thomp. on Corp., Sec. 8241.

It seems clear that there may be:

1. A complete or full consolidation.
2. A partial consolidation.

And again:

1. A *de jure* consolidation.
2. A *de facto* consolidation.

There may be:

1. A temporary consolidation.
2. A permanent consolidation.

The first division explains itself, just as the terms complete or partial "merger" explain themselves. So a *de jure* consolidation may be full or partial; and so a *de facto* consolidation may be full or partial.

And so a statute may provide for or allow generally a consolidation, full or partial, and may also specifically allow companies to do things *which amount in their essence* to consolidation, full or partial. In such case there would be a mere duplication of subject-matter.

Again, there may be *acts performed* by one corporation in respect to another corporation or its assets under or upon which

(1) the former will be held to have assumed the latter's debts and estopped to deny the same; or

(2) under which the former may be *estopped to deny* that it is a *consolidation* of the other, and *hence* that it has assumed such debts.

The cases in the books of absolutely full and complete consolidations are not so common. In most cases there are some remains of the old corporation in existence, at least for a time, or liable to respond to some suit or action on behalf of the state or others. There are *some* contract rights, etc., left unadjusted. If, therefore, no liability would attach to the new company, except when the merger had been or become absolutely full and complete, great injustice would occur in many cases. As we shall see, therefore, that in most cases where the new company—the consolidation—has been held liable the old company has been continued and operated to a certain extent and for certain purposes.

In view of the diverse classification above and this array of distinctions, it is no wonder that the courts, in treating cases with limited issues and in each instance one of many classes, got into difficulty when attempting to form a definition which would cover the whole field of "consolidation" and at once reveal all classes of cases falling within it.

And it is likewise apparent that a brief which would do justice to the whole subject of corporate consolidation would have to reach the proportions of an ordinary text-book.

We therefore intend to keep as close as possible to the specific case here presented, and treat very briefly that portion of the consolidation "field" immediately contiguous or surrounding it; this latter simply for the purpose of emphasizing the propositions, and "boxing" them in.

(IV.)

A Schedule of Vital Propositions.

1. It is often said that a complete consolidation of two corporations consists of a complete merging of property (or assets), franchises and stock.

But here again there are two classes of complete consolidations, because there are two classes of franchises of a corporation—the non-observance of which fact has led to considerable confusion in the decisions, or at least in the language thereof.

Every corporation is a creature of the state and is created for certain limited and specified purposes. Its creation and existence are, however, different or separate from the fulfillment of its purposes. It may do business along the lines of or within its chartered purposes, and after ceasing to do business, it does not thereby or *eo instante*, become extinct. The corporation still exists.

For a ceasing of business or other causes, *the state* can cause a surrender of the charter. But until it does the corporation exists as such. If the state should not act, and the corporation re-engages in business, no private person could complain, nor could he successfully raise the plea that the corporation had ceased to exist, or could not act.

The franchise *to exist* as a corporation is, therefore, distinct from the franchise to do a specified *business.*

"The absolute destruction of the former corporation has seldom been accomplished. In whatever mode a corporation be ended it is found that the

law, *i. e.*, the state, intervenes. A corporation is something distinct from its members. All these may leave it, yet it still exists; how, then, is it possible that any action of theirs unrecognized by the law, can destroy that which depends for its origin and continuance upon the law?"

Brice. Ul. Vir., 2d Ed., p. 710.

2. Two corporations may by certain specified methods consolidate all their property, their stock, their business franchises, and also the very substance of their corporate *existence*—their "franchise" to *exist* as a corporation.

Statutes allowing complete or the *completest* consolidation contemplate that upon consummation thereof the one corporation shall *go* out of existence.

But the mere fact that a corporation as such exists or has not become extinct cannot be in and of itself a defense to the claim that it has consolidated with another. Vol. 7, Ruling Case Law, § ....

3. A "true" or "perfect" or "direct" or the "completest" "amalgamation" (or consolidation) involves:

(1) A destruction, either actually by dissolution or substantially *by abeyance*, of the entity of the original or transferring corporation.

(2) A transfer of corporate rights and liabilities out and out, present or contingent, a transfer, in short, of the legal *corporate persona*.

(3) A transmutation of the members of the former corporation into members of the latter.

(4) A novation of the rights of creditors, etc.

The first two are connected with and specially relate to the corporations themselves.

The last two are totally distinct, and depend upon principles of the rights of individual shareholders and creditors.

Brice, U. V., 709.

4. Creditors cannot be *compelled* to sue the new company. A novation must be accomplished by consent of all parties.

Morawetz, § 808.
Brice, U. V., 724.

As to creditors the old one is treated as in existence and hence capable of suing and being sued, and having contracted the debt, no plea of *nul tiel corporation,* or other similar plea, would lie in its mouth to utter.

The new corporation would be liable because it had taken over *the assets and business* of the old, and was *continuing* the same for its own benefit, under a statute permitting it to do so, and expressly making it liable for the debts of the old.

Vol. 7, Ruling Case Law, §§ 155-6.

(And if the statute did not expressly so provide, the law would imply such a liability.)

Idem and 3 L. R. A. 435; 23 L. R. A. 231.

5. "Consolidations may and often do take the form of a *purchase* by one company of the stock of another.

The right to consolidate *includes* the right to purchase (and even destroy) the stock of another corporation.

Morawetz, § 942.
Thomp, on Corp. § 324 and § 8224.

In such case the purchasing company, owning absolutely all or the major portion of the stock in the other, and thus controlling it, takes possession of the assets of the other and uses or operates them as its own property and for its own benefit.

The Air Line-Belt relationship was an instance of such a consolidation.

The Belt Company held all of the Air Line stock. It operated the road directly, for its own benefit. It had the accounts against the Air Line charged directly to itself.

As owner of the Air Line stock, it kept alive the Air Line organization.

If it had surrendered or resold the Air Line stock, and given up to that company the control and possession of its assets (no other person's rights intervening) the consolidation would have been broken, and the original status restored.

The consolidation would have turned out to have been for a time only, or what was called by Lurton, J., in the Todd-Kentucky Land Company case, a "temporary" consolidation. (57 Fed. Rep. 56.)

While it had lasted, however, the Belt Company would have been liable for Air Line debts, and *estopped to deny* that there had been a consolidation or that it was so liable.

6. Two or more corporations can consolidate, using one of them as the absorbent corporation; or they can all be absorbed in a new corporation to be formed. Ashling case, 160 Ill., *supra.*

7. The distinguishing feature of a consolidation is the exchange of stock. *Morawetz,* Sec. 939, and 3 L. R. A., *supra.*

It is, therefore, apparent that although all the stock of the old corporation is not absorbed by the new, and that no matter how little is so absorbed where the exchange or acquirement of the stock is followed by the *acquirement of the assets* of the old corporation, there is nevertheless a consolidation *pro tanto*—where the statute allows such a proceeding.

(Here we have no case of a *minority* participation, and hence it will be unnecessary to follow out the effect thereof upon the rights of various creditors, lienholders and stockholders, etc.)

8. The capital and assets of a corporation constitute a trust fund for the payment of its debts.

The duties of the trustee (the corporation) are, that it will preserve the trust fund and manage it in the interest of the creditors and *seek to increase it* in the due prosecution of the chartered business of the company.

If, therefore, *another* corporation *appropriates* the trust fund and *continues* the business it quite naturally should be liable for the debts of the old. And this principle is the foundation for the statutes making consolidated corporations liable for debts of its constituents. *And this principle does not concern itself with the circumstances that the old stockholders contribute some cash to the deal.*

9. In case of an out and out sale in good faith to a new company, no such liability attaches. The old company has received the purchase money therefor, and the money stands as *a substitute* for the assets sold. The trust fund *remains*, and in *the form* of the substitute received. But where the new company is-

sues its stock for the old company's assets, it is not a purchaser for value. The *Key City,* 14 Wall. 653, *supra.*

10. In the case of an ordinary corporation, and where its assets have been thus turned over to another corporation in exchange for stock, the creditors of the old can *elect* to sue the new company, or to follow the assets and have their rights enforced against the property itself.

In the leading case of *Chicago, Rock Island & P. R. R. Co.* v. *Howard,* 7 Wall. 392, they *elected* to levy on the assets in the *form* of the value given old stockholders.

11. Now, the fact that it would be inequitable for stockholders of the old corporation obtaining or retaining an interest in its assets, by taking stock in the new or successor corporation (ahead of creditors), plus the fact that several corporate enterprises may often be situated as to suggest or prompt consolidation as a beneficial step or process, constitute the origin of the statutes *allowing* consolidation of corporations and specifically *providing* for the assumption of debts by the new company.

12. Again, where consolidation is allowed by statute it is permissible to use *any* methods not illegal in themselves which will bring about the *actual result.*

And even though a statute furnish a method therefor, such method is not exclusive, unless it be so specified. *The general* **authority** *to consolidate is ordinarily separate from the* **method** *provided therefor.*

Ashling case, 160 Ill., *supra.*

A general legal permission to one company to absorb or "swallow" another is *all the law needed* by the corporations *to justify the act,* no matter in what *manner* the act has been performed or the *actual* **result** *brought about.*

13. And so where consolidation takes place in a state where no exclusive method is furnished, the consolidation is legal and complete—*i. e., de jure*—when *the actual* consolidation has been fully accomplished; while

14. It may be a *de facto* consolidation when some details are yet to be done or accomplished.

15. "The contract of consolidation is an act of dissolution in form and substance of the Lebanon Company, and the corporation cannot in the act of dissolution dispose of the rights of its members. The act of dissolution, like the act of association, is not a corporate act, but an act of the members of the corporation. They may commit to their officers the business of effecting it in all its details, but they are not required to do so by the terms of their association, and in effecting such a purpose the officers would be rather trustees of the members than corporate functionaries."

Lauman v. *Lebanon Val. R. Co.,* 30 Pa. St. 46.

For this reason many statutes like those of Missouri provide for consolidations by mere contract or consent of the stockholders, in addition to the "vote" method.

V.

Consolidation under Missouri Statutes.

The statutes of Missouri in respect to corporations, like those of most of the states, have finally become through amendments made from time to time quite prolix, almost to the point of tediousness.

They form a good illustration of how the modern public have tried to remedy or thwart the evils of corporate administration with a very web of laws running to the merest detail,—a mere lot of mechanical fetters,—the chief result being a volume of waste consequent upon endless complexity.

A second feature of the Missouri statutes, and particularly of the sections bearing upon railroad consolidations, etc., is a duplication or overlapping of subject-matter. The three or four long sections bearing upon the subject could be reduced to less than a third in volume under the hand of a skilled draftsman. As will be found, the effort was to allow expansion, and at the same time under many explicit directions and prohibitions meet the threatened extinction of "competition."

The ever-recurring issue of "competition or co-operation" is revealed in these sections; as is also shown the erstwhile popular method of attempting to regulate this whole subject through prohibitive and mechanical laws alone, instead of by strong administrative and supervisory bodies, acting under general laws.

This is not the place to dwell at length upon the merits of this now universal issue. We simply say,

in passing, that it would seem that the American people are beginning to realize that "Sherman Acts" and Northern Securities decisions will not meet this issue; that combination with administrative regulation is simply healthy *co-operation;* and that, lastly, one of the duties up to the people and legislatures of the various states is to wipe off the statute books a great web of useless mechanical fetters.

The sections of the Missouri statutes which bear upon this subject of railroad consolidations are numbers 1059, 1060 and 1061. The first with which we are chiefly concerned is as follows:

> "SEC. 1059. COMPANIES MAY CONSOLIDATE, WHEN. Any two or more railroad companies in this state, existing under either general or special laws, and owning railroads constructed wholly or in part, which, when completed and connected, will form in the whole or in the main one continuous line of railroad, are hereby authorized **to consolidate in whole or in the main,** and form one company owning and controlling such continuous lines of road, with all the powers, rights, privileges and immunities and subject to **all the obligations and liabilities** to the state, **or otherwise,** which belonged to or rested upon either of the companies making such consolidation.
>
> In order to accomplish such consolidation, the companies interested may enter into contract fixing the terms and conditions thereof, which shall first be ratified and approved by a *majority in interest* of all the stock held in each company or road proposing to consolidate, at a meeting of stockholders regularly called for the purpose, or by the approval in writing, of the persons or parties holding and representing *a majority* of such stock.
>
> A certified copy of such articles of agreement, with the corporate name to be assumed by the

new company, shall be filed with the secretary of state, when the consolidation shall be considered duly consummated, and a certified copy from the office of the secretary of state shall be deemed conclusive evidence thereof. The board of directors of the several companies may then proceed to carry out such contract according to its provisions, calling in the certificates of stock then outstanding in the several companies or roads, and issuing certificates of stock in the new consolidated company, under such corporate name as may have been adopted."

(Here follows a prohibition against consolidation by competitive roads, either in whole or in part, and declaring that any such consolidation "shall be void," etc.)

"Before any railroad companies shall consolidate their roads, under the provisions of this article, they shall each file with the secretary of state a resolution accepting the provisions thereof, to be signed by their respective presidents and attested by their respective secretaries, under the seal of their respective companies, which resolution shall have been passed by a majority vote of the stock of each, at a meeting of the stockholders to be called for the purpose of considering the same, sixty days' public notice of the time, place and purpose of such meeting having been given by advertisement in some newspaper printed in the county where the general offices of said company or companies of this state are situated."

This section contains (1) a general authority for railroad companies to consolidate "in the whole *or in the main*" and casting a *full* liability upon the successor company in *either* case; (2) it provides two general methods of *consent* to consolidation which "may" (not must) be adopted, viz.: one under which the contract or terms of consolidation are fixed in the first instance by a majority *vote* of the stockhold-

ers of each company, and one needing only *the approval in writing* by such a majority; and (3) a prohibition against consolidation of competitive roads (immaterial here).

Sec. 1060 provides (a) that any railroad company may "aid" a connecting line company by means of subscription to its capital stock "*or otherwise;*" (b) for extension of, intra-state railroads into adjoining states allowing the one company to "build, buy, sell, lease or *consolidate*" with any railroads in such adjoining state; (c) for "any railroad company" to "lease or *purchase* all or any part of a railroad, with *all its privileges, rights, franchises,* real estate and other property, the whole or a part of which is in this state," *if the lines connect "within or without this* state," etc., and (d) that any railroad corporation (of another state) may extend its road "into and through this state, and for such purposes be treated as a domestic corporation," etc.

Then follows a provision for assent by a majority *vote* of the stockholders to such aiding, purchasing, etc., or other "arrangements" "or until the holders of a majority of the stock of such company shall have *assented thereto in writing,* and a certificate thereof signed by the president and secretary of said company or companies, shall have been filed in the office of the secretary of state," etc.

Sec. 1061 is of definite interest to us. It provides that any Missouri railroad corporation "may *acquire any line of railroad* within or without this state which shall form a continuous line," etc., "and may acquire *and may hold the obligations and stock* of other companies, *owning or operating* such lines of road,"

etc., Provided, that no such line of railroad shall be so *purchased* until "a *majority vote* of the stockholders of the companies shall have been taken in regular meeting," or until a *majority of the holders of the stock* of such company shall have consented thereto, in writing, and a certificate thereof, signed by the president and secretary of said company or companies shall have been filed in the office of the secretary of state."

Now we desire to point out in reference to these various provisions:

1. That the general authority to consolidate given at the outset of Section 1059 covered and made legal and permitted a consolidation under *any* method which would accomplish such *a result.*

2. In neither of the two methods outlined in such section for approval of or consent to the contract was it attempted to prescribe the contract itself or "the terms or conditions thereof." In other words, any *actual* method of consolidation, whether by *purchase* by one company of the stock of the other, or by an *exchange* of stock or otherwise, was expressly allowable under this section *independently* of the general clause *allowing* consolidations—provided consent was given in *either* of the two ways presented.

3. That consolidations could also actually and legally take place under the provisions of Sec. 1060 classified above as "(a)" and "(c)".

A company which would "subscribe" for all or nearly all of the capital stock of another (a), have the stock issued to it, and itself having the franchise of operating a railroad between the same points as

the constructed road, and which would then as the owner of the stock of the aided company cancel its stock or have it abandon operations and *enter upon possession* of such line of road would be a consolidation of said new company. So a company "purchasing" (c) the road of such connecting company might "*pay*" therefor with its *own stock*, and in that case, upon the former taking possession of the property, a consolidation would also result.

4. And likewise, under Section 1061, a company which should "*acquire* the stock" of any connecting line company, by means of *an exchange* of its own stock therefor, and *take possession* of and operate the line of such company, would be making thereby a consolidation with such company; and

5. *Such* a consolidation could take place as said above under Sec. 1059; the only difference, if any, being that under Sec. 1061, a mere *approval in writing* by a majority of the stockholders, and the filing of a certificate thereof by the president and secretary, etc., would be all that was necessary to make a full and complete *de jure* consolidation; while under the last provision of Section 1059 a majority *vote* of the stockholders "accepting the provisions" of "the article," etc., might also be necessary.

(It is doubtful if this last provision does not apply solely to the instance where the contract of consolidation is *ratified* in *the first instance* at a stockholders' meeting, and not where the contract is approved in writing by a majority, etc.,—an individual and not a corporate act—as per Lanman case, 30 Pa. St., *supra.*)

6. However, since there is a general authority for

these three companions to consolidate "in the whole or **in the main,**" and since no one *exclusive* method was provided therefor, we are here thrown back upon the question whether the transaction here in question was *in its essence* a consolidation "in the whole or in the main." And as a consolidation can be made by a mere *acquisition of the stock* (see Prop. 5, *supra*), the question is fully answered.

7. Even if not a complete consolidation, yet if the major part of *the stock* of the Belt Company was in fact consolidated and the Southern *took possession* of the property *under the contract* providing for such exchange, **full** liability on the part of the new company for the Belt debts results by virtue of the statute. **It was a consolidation "in the main."**

The legislature did not propose to allow a small portion of the stockholders to block the joinder of two enterprises which might be very beneficial to corporations and public alike. And on the other hand it proposed that in case of a *partial* consolidation of the companies or of their stock there should be no question about creditors' rights as against the absorbing company; *and that creditors should not be put to following the assets of the old company by proceedings in equity, etc., wherever the absorption should not be absolutely complete.*

(VI.)

Applying the foregoing rules and statutes to the case at bar.

The cardinal proposition deducible from above observations and which is the turning point in this whole case is this:

Any *contract or arrangement by which stock in one company, say Company A, is* **exchanged** *for stock in another company, say Company B, and in pursuance of which Company B* **enters into possession** *of or acquires the property of Company A is a* **consolidation** *of said companies.*

Under the "Reorganization Plan" in issue here, *97% of stock of the Belt Company* **was exchanged** *for stock in the Southern Company and* **under said plan,** *the Southern Company* **did acquire possession** *of the assets of the Belt Company and has since operated them for its own use.*

Whether the exchange of stock alone would constitute such consolidation to the extent of making the new company liable for Belt debts, that is, (1) whether the liability had attached in July, 1900, when the "prospectus" had been issued on the New York stock exchange stating that "substantially all" the Belt stock had been deposited and the Southern stock issued to depositing Belt stockholders (subject to the voting trust arrangement which is not material here) or (2) whether it only attached upon the instant of the Southern Company taking possession of the Belt property after the foreclosure in January, 1902, is not vital here. For the foreclosure was carried on *in the interest* of the depositors and *under the plan.*

As a matter of fact the liability did attach in 1900 by virtue alone of the express stipulation in the plan as to payment of floating debt.

Two important propositions held as law in the case of *Chicago, Santa Fe, etc., Ry. Co.* v. *Ashling*, 160

Ill. 373, a case often cited, are as follows (as per syllabus):

> "1. *A consolidation* and not a mere purchase by one corporation of the property of another, is affected by *a transfer* of all the property, stock and franchises of the latter, *under an arrangement by which the stock of the former is issued to the stockholders of the latter, in exchange for their stock.*"

(Write it "*any*" arrangement and the proposition will be still sound. Write it "*some* of the stock," and there will have been a consolidation *pro tanto.* Write it "*major portion of the stock*" and there will have been a consolidation **"in the main,"** which, under Sec. 1059, Missouri laws, will cast a **full** liability for all debts upon the absorbent corporation.)

> "2. A corporation which has **in effect** *consolidated with another* **is estopped** *to assert that the proceedings for consolidation were not in accordance with the terms of the statute,* in an action against it to recover the amount of a judgment against the other corporation on the ground that there was a consolidation."

That is to say, where the statute gives *permission* to one company to absorb or "swallow" another company, and the former *has actually* absorbed or "swallowed" the other it will be *estopped* to deny that *the act* was illegal. *The act has* **been permitted by law** *and* **the act** *has been done.*

At the time this case arose there was in force in Illinois,—

1. A statute of 1867 providing that in case of a consolidation of corporations, the new or consolidated company should be liable for the debts of the old or constituent companies.

2. A statute of 1872 providing for the consolidation of railroad companies, and prescribing a sixty-day notice to stockholders and the publication of a general notice for *nine successive weeks;* and also requiring that a certificate of such action to be filed with the secretary of state, etc.

3. A statute of 1885 authorizing all railroad companies "*to purchase* and hold in fee simple or otherwise" "and *to use and enjoy* the railway property, corporate rights and franchises of the company or companies owning such road or roads" (other connecting or leased roads) "upon such terms and conditions as may be agreed upon between the directors and approved by the stockholders owning not less than two-thirds in amount of the capital stock of the respective corporations becoming parties *to such purchase and sale;* such approval may be given of any annual or special meeting upon sixty days' notice," etc.

The Santa Fe Company was a lessee of the St. Louis Company and thus authorized to "purchase" the latter. Each company called a meeting of its stockholders upon sixty days' notice only (there was no nine weeks' publication, etc.), and by resolution authorized "a purchase" by the former "of all the property, effects, assets, corporate rights and franchises of every kind of the latter company," "and a deed of conveyance was executed to evidence the transaction" (p. 379). The consideration for the "purchase" was the assumption by the Santa Fe Company of the bonded indebtedness of the St. Louis Company and a certain amount of *stock* in the Santa Fe Company to be delivered to the St. Louis Com-

pany stockholders; and the Santa Fe Company entered into the possession and use of the St. Louis Company's road.

The court says:

> "The record does show that the proceedings of the two corporations were had under the Act of 1885, rather than under the Act of 1872. The resolution fully authorized the purchase * * * and the deed fully evidenced the transaction. It must, however, be conceded that if what is authorized to be done under the Act of 1885 *would amount to* a consolidation of the lessor with the lessee company it was competent for the legislature to prescribe steps, not unconstitutional, to be taken to effect such consolidation different from those prescribed by the Act of 1872."
>
> "Again, this is not a direct proceeding" (by the state) "to test the right of the Santa Fe Company to hold the franchises and property of the St. Louis Company * * * and if *the effect* of what has transpired between the two companies *amounts to a consolidation* of the St. Louis Company with the Santa Fe Company, the latter cannot, in this proceeding, be heard to say that it did not comply with the requirements of the statute, *but it is estopped therefrom.*"

Said further, that the effect of that part of the transaction *relating to the exchange of stock "was an act of consolidation,* and not necessary to a mere purchase and sale." * * * *There is no magic in words. Merely calling the transaction a purchase and sale would not prevent it from being a consolidation."*

Held further (382), that the mere fact that the St. Louis corporation "had been kept alive for certain purposes did not materially affect the question. It

may be that a consolidation of two corporations—or amalgamation, as it is called in England—*if full and complete,* may *work* a dissolution of them both, and its effect *may* be the creation of a new corporation," etc.

This Ashling case is clearly reasoned and has been adopted as sound by courts and text writers.

It will be noted that the statute of 1885, treated above, is substantially like the third clause of Section 1060 of the Missouri statute (referred to above as class "d"), providing for "a purchase" by one corporation of "the property and franchises" of the other, etc.

And it substantiates the assertion made above that a consolidation might be made under said "purchase" clause.

It also supports the claim that a consolidation can take place under Section 1061 providing for the "acquisition" of the stock of one company by another and calling it in one place "a purchase."

And it is thus evident that the Missouri statutes not only allow generally consolidation, but provide a very wealth of variety in the way of method therefor.

It is also evident at this point that as more than a majority of the stockholders in the Belt were pledged in writing—"assented in writing" to the " acquisition" or "purchase" of the Belt stock by the Southern and payment therefor *in stock* of the latter (*"an act of consolidation"*) and a certificate thereof having been filed by the president and secretary of the Southern Company, the latter, being a full *de jure*

corporation, is a full *de jure consolidation* of the Belt Company's *a,* property; *b,* franchise, and also, *c,* stock "in the main"—and its full liability for Belt debts follows.

Every legal requirement for such "acquisition"—which was, *in fact,* a consolidation—was complied with.

"There is no magic in words." And calling the transaction "a purchase" or "acquisition," or what not, "did not prevent it from being a consolidation" where the "*result*" or "what was done *amounted* to a consolidation."

And whether a deed was given to evidence the transaction directly from one company to another, or whether the scheme or arrangement provided for a foreclosure of bonds *acquired and held under and in the interest of the "contract" or plan* (in order to satisfy the rights of the 1 per cent. of non-depositing or non-consenting Belt stock), and that the taking of direct possession of the Belt property by the Southern should be simply deferred until *after it had received a deed* under the foreclosure, makes no difference.

The foreclosure, the issuance of the deed, the ultimate taking possession and acquirement of the property, were all had and taken in pursuance and "*under an arrangement* by which the stock of the former (the Southern) "is" (was) "issued to the stockholders of the latter" (the Belt) "in *exchange for their stock.*"

———o———

An instructive and well recognized case is *Williamson* v. *N. J. Southern R. R. Co.*, 26 N. J. Eq. 398,

which state has furnished so many valuable equity decisions.

The New Jersey Southern Railroad Company was given statutory power (p. 400) to unite with other companies whose railroads might connect with its road; and to that end to "consolidate the capital stock" upon a vote of two-thirds of the stockholders of each company proposing to unite.

The Long Branch & Sea Shore R. R. Co. was empowered by its charter acts "to consolidate" its capital stock with that of the Southern Company upon the terms mentioned above; or, "in lieu of such consolidation, the Southern Company might *purchase the stock* of the Sea Shore Company, or might purchase the road and *pay for it in capital stock* of the Southern Company," to be issued by the latter.

The Southern Company acquired 1,619 shares out of a total of 1,718 shares of the Sea Shore Company —about 16-17 of the whole issue—"and a consolidation of the road was, in fact, made. The Sea Shore Company ceased to keep up their separate organization, except as a *mere matter of form, in the interest* of the Southern Company." (Just what the Belt Company is doing in the interest of the K. C. Southern.) The Southern Company took possession of the Sea Shore road and spent its own money upon certain portions of its route, and the road of the latter became an indistinguishable part of the continuous line of the Southern road. "In fact, the consolidation was actual and complete in all respects. The purchase and sale and delivery of the stock (sixteen-seventeenths of the whole), by virtue of the legislative authority referred to, *for the purpose* of consol-

idation, and the consequent actual, practical and absolute consolidation, completely recognized in all things, will be held in equity to be a consolidation in accordance with the provisions of the acts. If the proceedings are lacking, it is not in substance, but form merely; the consolidation has been fully acquiesced in. If the consent of the stockholders of the companies does not appear, it has, nevertheless, been given. *The Southern Company* BOUGHT, *and the stockholders of the Sea Shore Company sold.* The board of directors of the former represented the *whole* of the stockholders of their company in the purchase, and the *stockholders of the Sea Shore Company acted for themselevs.* Two-thirds of the stockholders of each company have, *in fact*, consented to the consolidation. The Southern Company are *the owners* of two-thirds of the capital stock of the Sea Shore Company."

(There was no *vote* of the Sea Shore stockholders, although the statute specified this method of consent alone. This holding supports the holding in the Lauman case (30 Pa. St. 46) that in forming consolidations, the stockholders act as individual members of the company "rather than as corporate functionaries.")

Now, prior to such consolidation, the Southern road had given a mortgage upon all its property, both real and personal, and including all property, both real and personal, "to be thereafter acquired."

Jay Gould had been president of the Southern Company, and when the Sea Shore stock came into possession of the Southern Company, he, in some

manner, took it into his possession as collateral to his personal claim against the Southern Company.

The trustees in the mortgage filed a bill against him to recover the stock as included in and subject to the lien of the mortgage, and alleged that he took the stock with notice of the complainants' rights, etc. Gould demurred, but the bill was held good.

The chancellor said: "The acquisition of the stock, under the authority of the act of the legislature, was, as before stated, *the means by which the road of the Sea Shore Company was acquired,*" etc.

That is to say, "the road"—that is, *all* property, both real and personal—of the Sea Shore Company was acquired by the Southern Company by "means" of the stock, and the mortgage thus *operated directly* upon the property acquired, *because such a transaction was in fact a merger or consolidation of the companies.*

Now, it is evident that the two methods provided "in lieu of such *consolidation,*" viz., a purchase of the *stock* of the Sea Shore Company by the Southern Company, or a purchase of the *road* of the Sea Shore Company—and payment therefor by the issuance of *stock* in the Southern Company—*were simply other means of consolidation.* The *former* of the two substituted methods *was adopted,* and while one-seventeenth of the Sea Shore stock was *left outstanding,* and the *organization of that company was kept up,* yet the practical merging or mixing up of *the physical property* of both roads was held, with the *purchase of so much* stock, to *constitute a practical* consolidation; and this made the property of the old

Sea Shore Company the property of *the new and directly subject* to the lien of its mortgage.

This case sustains in full, the proposition that a transfer *of only a majority of* the stock of one company to another, with the abandonment *of the old corporation's business,* will constitute an *actual consolidation,* even though *the organization* of the old company is *kept up* in form. So far as the amount of stock acquired goes, there is no resting point between sixteen-seventeenths and a bare majority—the point at which control passes.

Section 1059 of the Missouri statutes above outlined, received some twenty years ago the judicial construction of that renowned legal giant, Mr. Justice Miller, upon the Circuit, and his opinion was adopted almost or *in toto* by the U. S. Supreme Court, without dissent.

The case was *Leavenworth, etc.,* v. *Chicago, R. I. & P. Ry. Co.,* 134 U. S. 688.

There was a Missouri corporation known as the Chicago and Southwestern Railway Company chartered in Missouri. There was *another* corporation by the same name chartered in Iowa.

These two companies entered into articles of consolidation on September 25, 1869 (p. 690).

There was a *third* corporation (under Missouri laws) known as the "Atchison Branch of the Chicago and Southwestern Railway Company."

On the 16th day of August, 1871, articles of consolidation were signed between the Chicago and South Western Company of the states of Missouri and Iowa (the consolidated corporation) and the "Atchison Branch."

"These articles were duly filed in the office of the Secretary of State of Missouri. The validity of that consolidation is assailed by the plaintiff on the ground that it is void by reason of a failure to conform to the laws of Missouri." (691.)

(Section 1059 here construed was in the same words as it is today, except only that the last three or four lines of the present section prescribing the notice for the stockholders' meeting for the purpose of "accepting the provisions of the act," occurring after the words "the same" were missing then—an immaterial difference.)

There had been a foreclosure of the bonds of the Southwestern Company after its purported consolidation with the "Atchison Branch" and covering the original bonds issued by the latter company on its road. The Chicago and Southwestern Company alone appeared in the foreclosure suit which was prosecuted to consummation and sale, the "Atchison Branch" not being a party thereto. The complainants filed a bill to set aside the sale, and contended that the proceedings were void or inefficient as to the Atchison Branch bonds, because the consolidation was void and therefore the Atchison Branch Company had not been foreclosed.

The specific ground of attack was that there had been no meeting of the stockholders of the respective companies "accepting the provisions of the article" and no certificate thereof filed in the office of the secretary of state.

Mr. Justice Miller held:

1. That the provision in the body of the article

in reference to attempted consolidations being "void if contrary to the provisions of this article" and immediately following the prohibition against the merging of "competitive roads," was simply in furtherance of such prohibition and did not relate to the *methods* of consolidation outlined in the article.

2. That the word "void" only meant that a joinder of competitive roads was *voidable* at the instance of the state.

3. That when a certified copy of the contract of consolidation "or the articles of agreement" should be filed with the secretary of state the consolidation was to be "considered as duly consummated" so far as concerned individuals or other corporations dealing with the consolidating company or "when it should come into a court of justice as plaintiff or defendant." (700-1.)

4. That the holding of the corporate meeting to "accept the provisions" of the act and the filing of the certificate thereof were mere directory provisions in reference to "a matter between the state and the corporations whose rights are affected." (700.)

With the use of these three leading and well recognized cases analyzed as above we can establish these further propositions:

1. That (a) the filing with the secretary of state of a copy of the "plan of reorganization" upon (b) the assent in writing of a majority stock holding in the Belt, with (c) a resolution of the stockholders of the Southern approving or acting under said plan followed by (d) *the taking possession* by that com-

pany of the Belt property, etc., would have "consummated" the consolidation of the two companies under the second *method* outlined in Section 1059, and this would be sufficient proof for the purposes of this case to hold the Southern upon the Guardian Trust claims.

2. It would have also shown a consolidation (even if the *vote* had been lacking) under Section 1060 and could be called "a purchase" for which Southern *stock* had been issued *in payment.*

3. And (without the *vote*) it would have also shown a consolidation under Section 1061 by calling it as it is sometimes called in the plan itself an "acquisition" of the Belt stock, for which Southern *stock* had been issued *in payment.*

4. That if an actual consolidation had been *effected,* and *by any method* NOT *expressly outlined in* ANY *of the three sections in question,* it would still be held legal under the *general* authority to consolidate given in Section 1059.

5. And there being a legal warrant *for* consolidation, if the steps taken *resulted* in an *actual* consolidation, the consolidated company *would be estopped* in this proceeding from asserting that the proceedings were void or inefficient. (And as the Southern Company *took possession* of Belt assets *under a plan* by which its stock *was exchanged* for Belt stock, it is *estopped* to deny that the consolidation was legal. Ashling case, 160 Ill., *supra.*

Conclusion.

Our argument has been long. But a many-featured subject is involved.

It is somewhat anomalous that a subject of such universal importance has not at this late day been judicially settled in all its main features.

It is hoped that in the interest of public economy and of court economy it soon will be settled. And we tender our feeble contribution towards the attainment of this end.

Respectfully submitted,

Newell H. Clapp,
Harry S. Mecartney,
For Respondent and Appellee.

No. [redacted] 35

APR 25 1914

JAMES D. MAHER

—IN THE—

Supreme Court of the United States

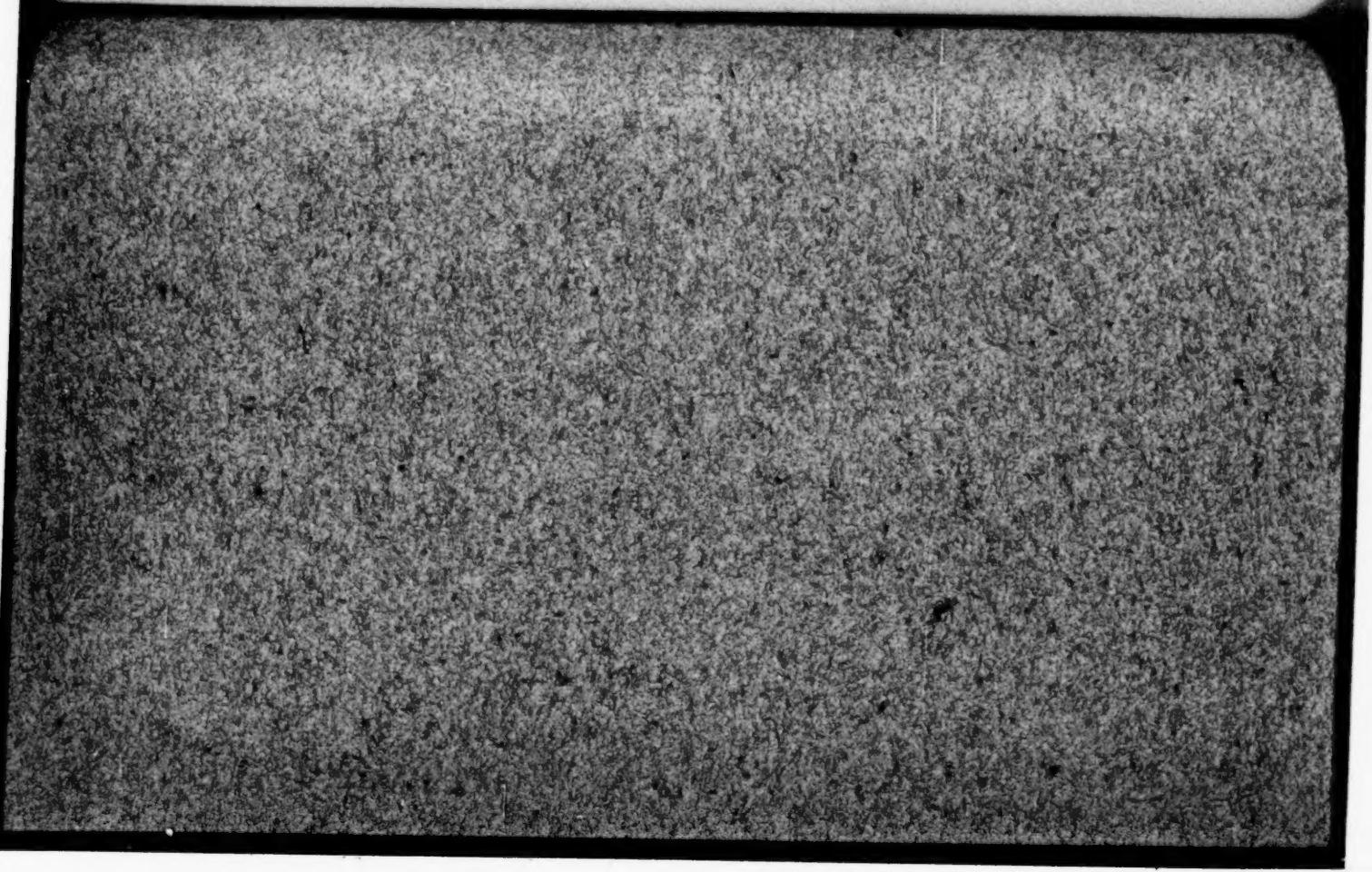
THE KANSAS CITY SOUTHERN RAILWAY COMPANY, *Appellant*,
vs.
GUARDIAN TRUST COMPANY, *Appellee*.

No. 941.

THE KANSAS CITY SOUTHERN RAILWAY COMPANY, *Appellant*,
vs.
CENTRAL IMPROVEMENT COMPANY, *Appellee*.

Brief of Appellant in Opposition to Motion of Appellee to Dismiss or Affirm.

SAMUEL UNTERMYER,
SAMUEL W. MOORE,
Solicitors for Appellant.



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vs.

CENTRAL IMPROVEMENT COMPANY, *Appellee*.

Brief of Appellant in Opposition to Motion of Appellee to Dismiss or Affirm.

It is important to bear in mind that the questions presented by this appeal for the consideration and determination of this court, involving a judgment or decree for over $700,000.00, are *essentially federal questions* arising under the laws of the United States. They involve the validity and effect, in a collateral proceeding, of a decree of foreclosure and sale of railway property, duly entered and made effective by a circuit court of the United States.

Our contention in this brief will be that the decision of the Court of Appeals was not final, and that this court has

jurisdiction over this cause upon this appeal for each of the following reasons:

First. The original bill of the Cambria Company in this case presented a distinct ground of federal jurisdiction independent of that of diversity of citizenship.

Second. The intervening petition of the Southern Company, which was in the nature of an original bill, stated facts sufficient to confer jurisdiction upon a federal court, independent of the grounds of jurisdiction stated in the original bill.

The main question upon the merits in this case is the same as would have been presented in the Boyd case (228 U. S. 482) if that case had contained the following *additional elements,* established by the undisputed testimony:

(a) If Boyd had been a party to the reorganization plan of the Northern Pacific Railway Company and, under the provisions of the plan, had exchanged his securities in the old company and had received, in lieu thereof, and had retained $1,480,909.20 par value of the securities of the new company.

(b) If it had been determined in an "adversary proceeding" to which Boyd was a party, that the fair market value of the Northern Pacific Railroad property, at the time of the foreclosure and sale, did not exceed the valid bonded indebtedness of that company, and that the property was sold at foreclosure sale for that exact amount.

(c) If Boyd, as a condition of participation in the reorganization plan, had executed a covenant that he would not hold the new reorganized company for any of the debts of the old company.

It is not intended, however, to present the merits of the case at this time, since that feature will be covered by a brief in support of our application for *certiorari,* which it is expected will be submitted with the appellee's motion to dismiss this appeal.

I.

General nature of the case brought here by appeal.

1. *The bill of the Cambria Company.* A consideration of this bill and the issues made by it are only important *for the purpose of ascertaining if the bill sets forth a distinct ground of federal jurisdiction independent of that of diversity of citizenship.*

In September, 1900, the Cambria Company filed a creditor's bill (Rec., 5-34), based on a judgment rendered in its favor by the United States Circuit Court for the Western District of Missouri against the Belt Company, and brought against the Belt Company, the Trust Company and others, asserting that the *lien of this judgment* attached to the *equitable* title of the Belt Company to certain real properties, the *legal title* to which was held or claimed by the Trust Company and certain auxiliary companies, and seeking a foreclosure of this *judgment lien* and a sale of the real properties *thereunder;* and also demanding an accounting between the Belt Company and the Trust Company, and seeking to subject certain stocks and bonds held by the Trust Company as collateral, to the payment of the complainant's judgment, if as a result of the accounting, the alleged indebtedness should be canceled and the collateral should be released. The litigation of the accounting feature was carried on under the ancillary bill of the Belt Company and its receivers, *infra,* as provided by stipulation (Rec., 1099, 1095). The finding and decree of the circuit court were against the complainant on the issues made by the bill and no appeal was taken. A more detailed reference will be made hereafter to the bill of the Cambria Company.

2. *The ancillary bill of the Belt Company and its receivers.* The issues made by this bill are of no importance here except as part of the history of the case. The Belt Company and its receivers by direction of the court (Rec., 35), and by stipulation (Rec., 1034), which provided that there should be an accounting between the Belt Company and the Trust Company, filed an ancillary bill and amendments (Rec., 116, 237, 456) against the Trust Company and others, seeking an accounting as between the Belt Company and the Trust Company and the release of the collateral held by

the latter. The decree of the circuit court (Rec., 1050) eliminated three items from the account, and gave judgment (Rec, 1052) in favor of the Trust Company and against the Belt Company in the total sum of $639,658.86. No appeal was taken by the Belt Company or its receivers for reasons stated at page 58 of our brief in support of our application of *certiorari*.

3. *The intervening petition of the Southern Company.* The questions raised by this appeal have *solely* to do with the *intervening petition* of the Southern Company and the *Trust Company's answer* thereto.

In February, 1905, it was stipulated (Rec., 191) that the Southern Company should be made a party to the cause either as joint complainant or by bill of intervention, as it might elect, and that the testimony theretofore or thereafter taken in the case should be considered in support of the issues made. Its intervening petition, *which was in the nature of an original bill,* was immediately filed (Rec., 195), in which it alleged that it was the purchaser at foreclosure sales under foreclosure decrees of the United States Circuit Court at Kansas City, of the railroad properties of the Belt Company, the Gulf Company, and the Air Line; that the mortgages executed by those companies upon their properties respectively, contained after-acquired property clauses, and that the liens of said mortgages attached in equity to the property and collateral held by the Trust Company as security for the alleged indebtedness of the Belt Company to it; and the Southern Company prayed that the collateral be awarded to it. In particular, the Southern Company alleged that certain terminal properties in Kansas City, Missouri, and in Kansas City, Kansas, had been purchased by the Belt Company, Gulf Company, and the Air Line, with moneys contributed by those companies respectively, for terminals and rights-of-way needed by them, the legal title being taken, for convenience, in the name of the Central Company which, it was charged, had been organized solely for the purpose of conveniently holding the legal title to such properties. The Southern Company averred that the lien of the mortgages of the Belt Company, the Gulf Company, and the Air Line, attached in equity to said properties at the times of their purchase and acquisition, and that the equitable title thereto had passed to it as purchaser under the foreclosure sale, and it

demanded either a conveyance of the properties to it, or a return to it of the capital stock of the Central Company which was held by the Trust Company as a part of its collateral security.

4. *The answer of the Trust Company to the intervening petition of the Southern Company.* The answer of the Trust Company sought to invoke the rule of *Northern Pacific Railway Company* v. *Boyd*, 228 U. S., 482, and asserted that the reorganization of the Gulf Company, Belt Company and their associated companies, resulting in the organization of the Southern Company, the appellant herein, was a *fraudulent scheme* which entitled the Trust Company to recover over $700,000 from the Southern Company, *notwithstanding the fact that the Trust Company was a party to the reorganization plan and benefited therefrom to the extent of approximately* $1,500,000, which it still retains.

The Trust Company, in its answer filed in March, 1905, (Rec., 218), alleged (Rec., 233) that a reorganization plan, contemplating the reorganization of the Gulf Company and its allied companies had been prepared and promulgated by a reorganization committee; that such plan contemplated the deposit with the committee of the stocks and bonds of the companies involved in the reorganization, and the organization of a new company, to-wit, the Southern Company, which should issue its stocks and bonds in exchange for the stocks and bonds of the old companies in certain specified proportions; that the exchange of stocks resulted in the stockholders of the Belt Company securing a large amount of the stock of the Southern Company which was alleged to be more valuable than the Trust Company's claim against the Belt Company, and it was averred that said scheme legally implied the payment by the Southern Company of the Trust Company's claim against the Belt Company.

5. *The master's report and decree.* The master's report was filed in May, 1910 (Rec., 659-1033). In addition to the finding upon the bill of the Cambria Company and upon the ancillary bill of the Belt Company and its receivers above referred to, the master found (Rec., 1031-1032) that the Southern Company was entitled to a conveyance to it of the lands of the Central Company; and that the Southern Com-

pany did not, by reason of the reorganization plan or otherwise, assume or agree to pay or become liable for the indebtedness of the Belt Company to the Trust Company. The Trust Company filed exceptions to the master's report. It excepted to the *inclusion* in the report of *any* finding on the issue of the liability of the Southern Company, but did not except to the *correctness* of the finding itself. The Belt Company and its receivers also excepted to the master's report.

The final decree was entered on June 25, 1910 (Rec., 1049), overruling all exceptions, confirming the master's report, dismissing the bill of the Cambria Company, rendering a judgment in favor of the Trust Company against the Belt Company in the sum of $639,658.86, and finding that the Southern Company did not assume or agree to pay the indebtedness of the Belt Company, and directing the Central Company to convey certain specified lands to the Southern Company.

6. *The appeal to the Circuit Court of Appeals.* The Trust Company was allowed an appeal, without supersedeas, to the Circuit Court of Appeals for the Eighth Circuit on August 10, 1910. An appeal was allowed on behalf of the Central Company on August 10, 1910, but on October 8, 1910, the orders allowing the appeal of the Central Company, and approving its supersedeas bond were set aside and vacated by the Circuit Court upon the ground that counsel purporting to represent the Central Company were not, in fact, authorized to appear for or represent it (Rec., 1083). The record on appeal contained only the pleadings and the report of the master. It did not contain any of the evidence.

7. *Proceedings in the Circuit Court of Appeals.* The case was argued before the Court of Appeals, composed of a circuit judge and two district judges in May, 1911. Three questions only were raised by the assignments of error of the Trust Company; first, that the issue of the liability of the Southern Company to the Belt Company was *not* in the case and should *not* be decided; secondly, that the decree was erroneous in requiring the Central Company to convey the specified property to the Southern Company; and, thirdly, that the court erred in requiring one-third of the costs to be paid by the Trust Company. There was no assignment of error directed to the *correctness* of the finding on the liability issue, assuming that issue to be in the case. In fact, counsel

for the Trust Company insisted that the liability issue was not in the case and should not be decided. They said in their return to a rule to show cause, etc. (Rec., 1146):

> That by reason of the former decision of this court, and by reason of the state of the proceedings and record in the cause from which this appeal is taken, *the question of the personal liability of The Kansas City Southern Railway Company for the debt of the Belt Company is not an issue and cannot be determined upon this appeal.*

In June, 1911, the judges of the Circuit Court of Appeals advised that they thought the liability issue was one of the issues made by the pleadings, and asked counsel to brief that question so that the court might determine whether it could consider the liability issue under the state of the record and, if so, whether there was a plain error in that regard which the court could notice on its own motion. Briefs were accordingly filed on December 1, 1911, and the case was submitted thereon, oral argument being denied.

On October 22, 1912, the Court of Appeals handed down the opinion reported at 201 Fed. 811 (Rec., 1163), reversing the decree of the circuit court and directing the lower court to enter a specific decree in favor of the Trust Company and against the Southern Company for some $700,000. In January, 1913, a reargument was had, and on December 2, 1913, a second opinion was handed down adhering to the former conclusions of the court (Rec., 1216), copies of which second opinion are lodged with the Clerk of this court.

8. *Appeal to this court.* On January 24, 1914, the Circuit Court of Appeals allowed the Southern Company's appeal to this court (Rec., 1253), fixing the supersedeas bond in the sum of $600,000, which has been duly given.

9. *Application to this court for a writ of certiorari.* The Trust Company insists that the decision of the Court of Appeals is final, and that no appeal should be allowed to this court. Out of an abundance of caution, and in accordance with the settled practice where the right to an appeal to this court from the Court of Appeals is controverted, the Southern Company will submit to this court its application for writ of *cer-*

tiorari at the same time that the Trust Company's motion to dismiss is submitted, so that the motion and the application may be considered together.

II.

The original bill of the Cambria Company not only demanded an accounting, but also sought to establish and enforce a judgment lien, created by Act of Congress, and therefore, the jurisdiction of the Circuit Court was not entirely dependent upon diversity of citizenship.

If the bill of the Cambria Company stated facts sufficient to present a distinct ground of federal jurisdiction independent of that of diversity of citizenship, then the decision of the Court of Appeals was not final and the motion to dismiss the appeal must be overruled. (*Mayor of Vicksburg* v. *Henson*, 34 Sup. Ct. Rep. 95; *Warner* v. *Searle*, 191 U. S. 195; *St. Louis Railway Company* v. *Wabash Company*, 217 U. S. 247; *Howard* v. *United States*, 184 U. S. 676; *Union Pacific Ry. Co.* v. *Harris*, 158 U. S. 326; *Mississippi Commission* v. *Railway Company*, 203 U. S. 335; *United States Fidelity Company* v. *Bray*, 225 U. S. 205). Even though the averments are "quite defective" the appeal will not be dismissed (*Warner* v. *Searle*), (*supra*).

It is the *face of the bill* of the Cambria Company to which we must look for the jurisdictional averments. It is not material or important what questions arising upon the issues made by this bill were actually decided. (*Florida Central* v. *Bell*, 176 U. S. 321; *Omaha Electric Co.* v. *Omaha*, 230 U. S. 123; *Siler* v. *Louisville Railway Company*, 213 U. S. 175).

It becomes necessary, therefore, to examine the bill of the Cambria Company (Rec., 5-34), bearing in mind the Act of Congress of August 1, 1888, entitled "An Act to regulate the liens of judgments and decrees of the Courts of the United States" (25 Stat. L. 357) which provides that:

> Judgments and decrees rendered in a circuit or district court of the United States within any state shall be liens on the property throughout such state, in the same manner, and to the same extent, and under the same condi-

tions, only as if such judgments and decrees had been rendered by a court of general jurisdiction of such state; provided, that whenever the laws of any state require a judgment or decree of a state court to be registered, recorded, docketed, indexed, or any other thing to be done, in a particular manner, or in a certain office or county, or parish in the State of Louisiana, before a lien shall attach, this act shall be applicable therein whenever and only whenever the laws of such State shall authorize the judgments and decrees of the United States courts to be registered, recorded, docketed, indexed, or otherwise conformed to the rules and requirements relating to the judgments and decrees of the courts of the State.

And also the following statutes of the State of Missouri (1909):

Section 3123. Judgments and decrees obtained in the Supreme Court, in any United States District or Circuit Court, held within this state, in the Kansas City Court of Appeals or the St. Louis Court of Appeals, shall upon the filing of a transcript thereof in the office of the clerk of any such court, be a lien on the real estate of the person against whom such judgment or decree is rendered situate in the county in which such transcript is filed.

Section 3124. Judgments and decrees rendered by any court of record shall be a lien on the real estate of the person against whom they are rendered situate in the county for which the court is held.

The bill of the Cambria Company may be summarized as follows:

(a) After the formal averment of the incorporation and citizenship of the parties it is alleged (Rec., 7) that the Cambria Company on September 6, 1900, obtained judgment in an action at law in the Circuit Court of the United States for the Western Division of the Western District of Missouri, against the Belt Company in the sum of $100,962.91; that execution was issued and returned wholly unsatisfied; and that the Belt Company had no property subject to be reached by legal process issued upon the judgment.

(b) It is next charged (Rec., 7) that the Trust Company organized a large number of railroad companies to construct

railroads, and a large number of auxiliary companies, the latter for the purpose of holding legal title to lands, buildings and other structure necessary to be used by the railroad companies in their operations; that the Trust Company controlled these companies by the election of its own officers and employes as their officers and employes, and used them for its own benefit, and that thereby it assumed a fiduciary relation toward them; that among the companies so organized (Rec., 9-12) were the following railroad companies, Kansas City Suburban Belt Railroad Company and its subsidiary companies, the Union Terminal Railroad Company, Kansas City, Independence Air Line; and the following auxiliary companies (Rec., 13); Missouri Elevator & Terminal Company, Central Improvement Company, Second Street Improvement Company, Fairmount Amusement Company, and Northern Townsite Company.

(c) With reference to the railway companies it is charged at some length and with considerable detail, that the Trust Company appropriated all of their stocks and bonds and applied a portion of the proceeds thereof to the cost of construction of their properties, and refused to account for the remainder, and an accounting was demanded.

(d) With reference to the auxiliary companies it was charged that the Trust Company fraudulently invested them with the legal title to various properties, both personal and real, which in equity belonged to the Belt Company, and the Cambria Company sought by its bill to impress its *judgment lien* upon them. It is alleged (Rec., 13) that the Trust Company acted:

> With the fraudulent intent and purpose of preventing the properties so taken in the names of said auxiliary companies, respectively, from being reached by the creditors of said railroad companies or either of them and particularly by the creditors of the said Belt Company * * * that, as your orator is informed and believes, all or substantially all of the moneys invested in the purchase, improvement and acquisition of the several properties of the said auxiliary companies and each of them, was paid and supplied by the said Belt Company, and each and every one of the said auxiliary companies was a mere device or "dummy" contrived and provided by the said Trust Company as a means for taking and holding the naked *legal title* to such properties as might be vested

in the said auxiliary companies, respectively, for the use and benefit of the said Belt Company, and that, as to the creditors of the said Belt Company and particularly as to your orator, *the properties and shares of stock of each and every of the said auxiliary companies in equity belongs to the said Belt Company and are chargeable with the lien and payment of your orator's aforesaid judgment against the said Belt Company;* a list of real estate in the name of the auxiliary companies so far as known to complainant, is attached hereto as Exhibit 2. (Exhibit 2, Rec., 28-33, being a list of real estate situated in Kansas City, Missouri).

(e) It is next averred (Rec., 18, 19), that the Trust Company fraudulently, by reason of its control and domination, caused the Belt Company to transfer and deliver to it certain promissory notes and a large amount of property of various kinds, consisting of bonds, shares of stock, steel rails and other property, all of which it is charged rightfully and in equity belonged to the Belt Company, and should be subjected to the *judgment lien* of the complainant. It is alleged (Rec., 19):

> Your orator charges that each and all of the aforesaid shares of stock, assets and other personal property so passing into the possession of the said Trust Company, constitute assets and property of the said Belt Company, *equitably and justly chargeable with the lien and payment of your orator's aforesaid judgment*, and that the said shares of stock and other property were fraudulently taken into the possession of said Trust Company without consideration moving from the said Trust Company, and that said Trust Company has no right to such possession or title to any part of said stocks, or property.

(f) It is further charged that the Elevator Company, owning several elevators in Kansas City, Missouri, was a mere device or dummy to hold the legal title to its property for and on behalf of the Belt Company; that the Central Company (Rec., 21), was likewise a mere dummy contrived by the Trust Company to hold and carry the legal title to the real property standing in its name for the use and benefit of the Belt Company and its creditors; that the same was true of the Second Street Company, which among other things, held the legal title of certain tracts of real estate in and near Kansas City,

Missouri, and used and indispensably necessary to be used by the Belt Company for depot grounds, necessary buildings, rights of way, yards, freight houses and machine shops; and:

> That the said property in equity belongs to the said Belt Company and is chargeable with the debts and liabilities thereof, including the *judgment* of your orator as aforesaid.

It is also charged that the property and assets, the legal title to which is held by the Amusement Company and the Townsite Company, respectively, are essential and indispensable to the successful operation of the property of the Belt Company, and that the Amusement Company and Townsite Company are dummies of the Trust Company for the purpose of holding the legal title to said assets and property for the use and benefit of the Belt Company, as the equitable owner thereof, and,

> That such assets and property so held are equitably and justly chargeable with the claims and demands of the creditors of the said Belt Company, and particularly the *judgment* so obtained by your orator as aforesaid.

(g) Then follows a prayer for the *establishment of the lien of complainant's judgment* against the Belt Company's equitable title to the various properties held for it by these dummy corporations as follows (Rec., 23):

> That the property and assets, the legal title to which is held, respectively, by the said Elevator Company, Amusement Company, Central Company, Second Street Company, and Townsite Company be declared to be in equity the property of the said Belt Company, and chargeable with the *lien* and payment of the debts and liabilities of the said Belt Company, and, particularly, the judgment aforesaid of your orator.

Next follows a prayer for the sale and distribution of the assets and property of the Belt Company in the order of the respective liens of its creditors as follows:

> (d) That the assets and property of the said Belt Company, real, personal, or mixed, and wheresoever situated, including all rights of action, legal or equitable, be marshalled for the benefit and protection of all persons concerned therein.
>
> (e) That the rights and interests of all persons in

and to the said assets of the said Belt Company, be ascertained, adjudicated and decreed.

(f) That the said assets and property, and each and every part thereof, be sold and the proceeds thereof, after paying the costs and expenses of this proceeding and all allowances which may be made therein be distributed among those found to be entitled thereto.

(h) It is beyond question that the bill asserted a *judgment lien,* created by an act of Congress, upon the equitable title of the judgment debtor to various properties both real and personal, which were held or claimed adversely by the Trust Company, and sought to impress and establish such judgment lien upon these properties and to foreclose the lien and sell the properties and to distribute the proceeds to the parties equitably entitled thereto.

It is equally beyond question that the Trust Company *understood* that this was one of the issues tendered by the bill, for it says in its answer (Rec., 59), that it,

> Denies that all or any of the said companies were mere devices or dummies contrived and provided by this defendant as a means for taking title to such property as might be vested in them for the use and benefit of the Belt Company, and denies that the properties and shares of stock of the so-called auxiliary companies in equity belong to the Belt Company *and are therefore chargeable with the lien of the complainant's said judgment as alleged in the bill of complainant.*

(i) The Cambria Company on January 22, 1914, (Rec., 1250) applied to the Court of Appeals for leave to amend its bill, making a specific reference to the Act of Congress of August 1, 1888, and to the Missouri Statutes, above quoted, in reference to judgment liens, and by stating in express language that the suit arose under the laws of the United States, invoking the rule of *Vicksburg* v. *Henson,* 34 Sup. Ct. Rep., 95, which permits additional grounds of jurisdiction, existing at the time of the filing of the original bill, to be added by amendment. The Court of Appeals denied leave to make the amendment (Rec., 1251). The allegations of the proposed amendment are in respect of matters of which the court will take judicial notice, so that the action of the Court of Appeals in denying the motion is not important.

III.

Where, as in this case, the bill asserts a judgment lien created by Act of Congress and seeks to establish and enforce the lien against the equitable title to certain properties of the judgment debtor, the action arises under the laws and constitution of the United States and presents a distinct ground of federal jurisdiction independent of that of diversity of citizenship.

The lien of the judgment rendered in the federal court was solely a creature of the federal statute. The validity and effect of the lien as well as of the statute itself were involved in the case. The decree establishing or denying the lien claimed by the complainant would naturally turn upon the validity, construction, and effect of the statute.

Where the case made by the plaintiff is one which depends upon the proper construction of an act of Congress with the contingency of being sustained by one construction and defeated by another, it is one arising under the laws of the United States. (*Northern Pacific Railway Co.* v. *Soderberg*, 188 U. S., 528; *Ex Parte Lennon*, 156 U. S., 548).

As an illustration of the application of this rule to this case it is pertinent to inquire:

(a) Did the lien created by the Act of August 1, 1888, extend to the *equitable title* of the judgment debtor to the real properties described in the bill? (The judgment lien created by the Missouri Statutes above quoted, which statutes may or may not be a part of the federal act, extends to equitable as well as legal interests. *Williams* v. *Lobban*, 206 Mo. 3399, 410; *Eneberg* v. *Carter*, 98 Mo., 647, 650; *Slatterly* v. *Jones*, 96 Mo., 216).

(b) Did the act of Congress adopt these Missouri Statutes and with them its construction by the Missouri courts?

Upon the determination of these questions the existence and validity of the lien of the complainant may depend.

These questions appear *on the face* of the bill of the Cambria Company, and at once *involve and require a construction of the act of Congress*, with the necessary result that

by one construction of the act the right of the complainant will be sustained, and by another construction such right will be defeated.

But it has been expressly determined by this court (*Cooke v. Avery*, 147 U. S., 375), *that an action which seeks to establish and enforce a judgment lien created by an act of Congress is an action arising under the laws of the United States.* There the contest was over certain real property and the plaintiff alleged that he derived his title from the sale of the property under the *lien of the judgment* rendered by the Circuit Court of the United States for the Northern District of Texas, and the action was sustained as one arising under the laws and constitution of the United States, without regard to the citizenship of the parties, for the reason that the validity of the plaintiff's title depended upon the *existence of the lien* and the determination of that question involved the *construction and application of the act of Congress which created the lien.*

The act of Congress relied upon was the Act of June 1, 1872 (Sec. 916, Revised Statutes), which provided that the parties recovering a judgment in any common law action should be entitled to similar remedies by execution or otherwise, to reach the property of the judgment debtor as were then provided in like causes by the laws of the state in which such court was held or which should be thereafter adopted by rule of court. This was the statute which preceded the Act of August 1, 1888, which expressly gave a lien to the judgments of the courts of the United States.

The court said, in upholding the jurisdiction of the court:

> Plaintiff is to be regarded as the purchaser at the sale, and the *validity* of his purchase turned upon the *existence of a lien*, which he asserted and the defendants denied. The *disposition of this issue* depended upon the laws of the United States and the rules of the circuit court, and *their construction and application were directly involved.* We are of opinion that jurisdiction as resting on the subject-matter was properly invoked.

Does not this case conclusively establish our right to an appeal? The right of the Cambria Company to relief turned upon the *existence of the judgment lien* created by act of Congress, which the Cambria Company asserted and the Trust Company denied. Did not the disposition of this issue depend

upon the laws of the United States, and was not the jurisdiction of the lower court as depending upon the subject-matter properly invoked?

The same conclusion was reached by the Circuit Court of Appeals of the Fourth Circuit in *First National Bank* v. *Society for Savings*, 80 Fed., 581. There a federal circuit court issued a mandamus requiring the county court to levy a tax to pay a judgment against the county. Certain inhabitants of the town filed a bill in the state court to enjoin the levy on property in the town, claiming that such property was not subject to the claim upon which the judgment was based. This injunction suit was then removed by defendants to the federal court. It was held that the latter court had jurisdiction of the injunction suit, *as it involved the enforcement of a judgment of a federal court acting under the federal laws and constitution.* The court said:

> This proceeding is in the nature of an execution. The rights of the parties to the judgment in respect of its subject-matter are fixed by its rendition. *City of Chanute* v. *Trader*, 132 U. S., 210. This being so, the proceeding in the state court involves the enforcement of a judgment of the United States Circuit Court, acting under the constitution and laws of the United States, and it is, therefore, *a question arising under that constitution and those laws*, and so within the jurisdiction of the federal court.

The case of *Sowles* v. *Witters*, 46 Fed., 497, is also directly in point. It is there held:

> The laws of a state respecting the enforcement of judgments, adopted, pursuant to Rev. St. U. S. 916, by a rule of the federal district court for the government of judgment liens of such court, and for the guidance of the marshal in levying executions, derive their force from the United States, and not from the state; and a suit involving *the question whether or not the marshal's proceedings in levying an execution issued out of the federal court was in conformity with such rule is a question arising under the laws of the United States, and cognizable by the federal courts.*

The reason of the rule finds support in many adjudicated cases. An action on the bond of a marshal of the United States, or on the bond of a clerk, or on the official bond of a cashier of a national bank, or on the bond of a federal con-

tractor given for the protection of persons furnishing materials and labor for the construction of public works, or on a supersedeas bond, are held to arise under the laws of the United States for the reason that the case depends upon the scope and effect of the bond and the meaning of the statute under which it was given. (*Bock* v. *Perkins*, 139 U. S., 628; *Howard* v. *United States*, 184 U. S., 676; *Walker* v. *Bank*, 56 Fed., 76; *Hill* v. *Surety Company*, 200 U. S., 197; *United States* v. *Bonding Co.*, 89 Fed., 925; *United States* v. *National Surety Co.*, 92 Fed., 549; *United States* v. *Rundle*, 100 Fed., 400; *Hardaway* v. *Surety Company*, 150 Fed., 465; *Seymour* v. *Phillips*, 7 Biss., 460).

An action against a corporation created by Congress is one arising under the laws of the United States for the reason that the corporation has no powers and can incur no obligations except as authorized or provided by its charter. (*Removal Cases*, 115 U. S., 1; *Railway Co.* v. *Cox*, 145 U. S., 593.) Likewise, an action on an injunction bond given in the course of proceedings in the federal court arises under the laws of the United States for the reason that it is to be construed with reference to the liability administered in the courts of the United States on that subject. (*Tullock* v. *Mulvane*, 184 U. S., 497; *Railway Company* v. *Elliott*, 184 U. S., 530.)

That diversity of citizenship also existed in this case is not important. Nor is it material that the pleader in framing the bill may not have had in mind the assertion of any other ground of jurisdiction than that of diversity of citizenship. The controlling feature is that the complainant did assert a judgment lien upon the equitable title to certain real estate, and this judgment lien depended for its *existence* and *validity* upon an act of Congress, and upon the *construction of the act of Congress* creating it. These facts constituted a suit arising under the laws of the United States and gave to the circuit court an independent ground of jurisdiction in addition to that of diversity of citizenship.

IV.

The intervening petition of the Southern Company was a suit arising under the laws of the United States and for that reason alone the right of appeal to this court exists, regardless of the source of jurisdiction of the Cambria bill.

The decision of the Court of Appeals in this case was not final for the further reason that the intervening petition of the Southern Company (which was in the nature of an original bill) asserted the equitable title to certain real and personal properties held or claimed by the Trust Company, based upon foreclosure decrees rendered in the United States Circuit Court for the Western District of Missouri and sales had thereunder at which the Southern Company became the purchaser. It was, therefore, a "*case arising under the laws of the United States establishing the circuit court and vesting it with jurisdiction;* and hence, it would be *within the judicial power* of the United States as defined by the Constitution." (*Dupasseur* v. *Rochereau*, 21 Wall., 130; *Pittsburg Railroad Co.* v. *Long Island Trust Company*, 172 U. S., 493, 508; *Tullock* v. *Mulvane*, 184 U. S., 497.)

There was involved the Constitution of the United States (Article III, Section 1) providing that the judicial power of the United States should be vested in the Supreme Court "and in such inferior courts as Congress may from time to time ordain and establish," as well as the numerous acts of Congress defining the jurisdiction of the circuit courts of the United States and prescribing their procedure; and particularly the Act of March 3, 1893, entitled, "An Act to regulate the manner in which property shall be sold under orders and decrees of any United States courts" (27 Stat. L., 751).

The equitable title asserted by the Southern Company, as appears from the face of its petition, depended upon the *validity* of the foreclosure proceedings and the sales thereunder, and there was involved, therefore, the laws of the United States establishing the court, defining and limiting its jurisdiction of the subject-matter as well as of the parties, regulating the procedure in the course of the litigation, and prescribing with particularity the manner in which property shall be advertised and sold under the decrees of the court.

The title asserted by the Southern Company would be defeated by a construction of the laws of the United States that would deny the jurisdiction of the courts passing the decrees, either over the subject-matter or of the parties, or would invalidate the sale by reason of a failure to conduct it in accordance with the federal statute.

It was a necessary part of the case of the Southern Company that *under a proper construction of the acts of Congress* the courts passing the foreclosure decrees and conducting the sales had jurisdiction of the subject-matter and of the parties, the prescribed procedure had been followed and the sale had been made in the manner and at the place designated.

In other words, the Southern Company set up a right to recover as the result of a judicial sale made under a decree of the United States Circuit Court and, therefore, a federal question was presented.

This court, speaking through the present Chief Justice (*Commercial Publishing Co.* v. *Beckwith*, 188 U. S., 567), said:

> As in the complaint the plaintiff in error unquestionably set up a right to recover as the result of a judicial sale made under decrees, both of courts of the United States and of a state, federal questions exist in the record, and the motion which has been made to dismiss is therefore denied.

In *State* v. *Frost*, 89 N. W., 915, foreclosure proceedings brought in a federal court against a railway company had ripened into a decree. The master was unable to make a sale of the property at the up-set price named in the decree and reported that fact back to the court and asked for instructions. The court directed the receiver to take up the rails and ties for the purpose of selling them separately. The State of Wisconsin thereupon brought an original proceeding in the Supreme Court of Wisconsin to enjoin the receiver from taking up the rails and dismantling the road. Application was then made by the defendant to remove the case to the federal court upon the ground that the action arose under the laws and constitution of the United States. The right of removal was sustained, the court saying:

> It cannot be doubted that *the jurisdiction of the federal court depends wholly upon the constitution and laws of*

> *the United States;* nor that its power, after the expiration of a term, to modify a decree already entered, depends wholly upon the construction to be given to the *laws of Congress originating that court, and granting and defining its powers.*

Cooke v. *Avery*, 147 U. S., 375, and other cases cited under the preceding heading are also referred to as authority for this position.

Where an ancillary bill upon its face presents federal questions, the right of appeal to this court from the Circuit Court of Appeals exists, regardless of the source of jurisdiction of the main action. This has been expressly decided by this court in the recent case of *Railroad Commission of Ohio* v. *Worthington*, 225 U. S., 101. There, Worthington, who had been appointed receiver in an action depending solely upon diversity of citizenship, brought an ancillary bill to enjoin the enforcement of an order of the Railroad Commission of Ohio, invoking the Constitution of the United States, so that federal questions were presented on the face of the bill. The question arose as to whether a determination by the Circuit Court of Appeals of the issues made by the ancillary bill was final, and this court held that it was not, and that the appeal had been properly allowed, saying:

> The argument that the jurisdiction of the circuit court of appeals is final is based upon the contention that, as Worthington, the complainant in the present case, was appointed receiver of the Wheeling & Lake Erie Railroad Company in a suit in equity in the circuit court of the United States for the northern district of Ohio, eastern division, wherein jurisdiction depended upon diversity of citizenship, and since the jurisdiction to entertain an appeal in an ancillary proceeding is that of the original case, therefore, under the circuit court of appeals act, the decree of the court of appeals is final. It is undoubtedly true that in cases of intervention in *foreclosure suits*, where jurisdiction depends upon diverse citizenship, jurisdiction of the intervening petition is determined by that of the original case. It is equally true that petitions in original proceedings to enforce rights

and to protect the exercise of the jurisdiction of the court take their jurisdiction from that of the original case (*St. Louis, K. C. & C. R. Co.* v. *Wabash R. Co.*, 217 U. S. 247, 54 L. Ed. 752, 30 Sup. Ct. Rep. 510), and the many previous cases in this court therein cited.

An examination of the bill in this case, which was filed under the authority of the circuit court, shows that the order of the commission was attacked, not only upon the ground that its findings were alleged to be unsupported by the testimony and to have been made upon improper consideration of the facts, but also because the order affected and interfered with interstate commerce, in which the complainant was engaged and over which the Railroad Commission of Ohio had no authority because of the commerce clause of the Federal Constitution. It further was alleged that the owners of the property constituting the receivership estate would be deprived thereof without due process of law; that they would be denied the equal protection of the laws, and that their property would be taken without compensation. *It thus appears that jurisdiction was invoked, not only because the present case is ancillary to the receivership suit, which depended upon diverse citizenship, but upon grounds which involve alleged infractions of the Federal Constitution and rights secured thereby.* The case was therefore one which might have been taken to the circuit court of appeals, and the fact that it involved grounds which might have warranted a direct appeal to this court did not deprive the circuit court of appeals of jurisdiction. *American Sugar Ref. Co.* v. *New Orleans*, 181 U. S., 277, 45 L. ed. 859, 21 Sup. Ct. Rep. 646; *Macfadden* v. *United States*, 213 U. S., 288, 53 L. ed. 801, 29 Sup. Ct. Rep. 490.

The question, then, is: Is this one of the cases made final in the circuit court of appeals by the act creating that court? The 6th section of that act provides that the judgment of the circuit court of appeals, "shall be final in all cases in which the jurisdiction is dependent upon the opposite parties to the suit or controversy being aliens and citizens of the United States; also in all cases arising under the patent laws, under the revenue laws, and under the criminal laws, and in admiralty cases." (26 Stat. at L. 828, chap. 517, U. S. Comp. Stat. 1901, p. 550). In all other cases there is a right of review by this court if the matter in controversy exceeds $1,000. It is averred in the bill and admitted in the answer that the amount in dispute exceeds in value the sum of $5,000. *The case is therefore one not made final in the circuit court of appeals, and the appeal to this court was properly allowed.* *Spreckles Sugar Ref. Co.* v. *Mc-*

Clain, 192 U. S., 397, 48 L. ed. 496, 24 Sup. Ct. Rep. 376; *Macfadden v. United States*, 213 U. S., 288, 294, 53 L. ed. 801, 802, 29 Sup. Ct. Rep. 490; *Standard Paint Co.* v. *Trinidad Asphalt Mfg. Co.*, 220 U. S., 446, 460, 55 L. ed. 536, 543, 31 Sup. Ct. Rep. 456.

We understand the present state of the law on this subject to be as follows:

(a) Where it is sought to appeal from a decision of the Court of Appeals rendered upon the issues made by an intervening petition or an ancillary or dependent bill which does not itself disclose upon its face grounds of federal jurisdiction, the right of appeal is to be referred to the original bill which first invoked the jurisdiction of the lower court. If the sole ground of jurisdiction disclosed on the face of the original bill was diversity of citizenship, then no appeal lies; but if the bill disclosed a cause of action arising under the laws of the United States, whether stated separately or in connection with a ground of jurisdiction founded upon diversity of citizenship, the right of appeal from the Court of Appeals to this court exists.

(b) Where it is sought to appeal from a decision of the Court of Appeals rendered upon the issues made by an intervening petition or an ancillary or dependent bill which discloses on its face grounds of federal jurisdiction, then the right of appeal exists, regardless of the source of jurisdiction disclosed on the face of the original bill as filed in the lower court.

It is the contention of the appellant in this case that it has a right of appeal to this court: *first*, for the reason that the bill of the Cambria Company disclosed a cause of action of which the circuit court would have had jurisdiction independent of diversity of citizenship; and, *secondly*, that the intervening petition of the Southern Company sets forth a cause of action arising under the laws of the United States, and for that reason the right of an appeal exists wholly independent of the grounds of jurisdiction contained in the bill of the Cambria Company.

Respectfully submitted,

SAMUEL UNTERMYER,
SAMUEL W. MOORE,
Solicitors for Appellant.

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NUMBER [redacted]

IN THE

Supreme Court of the United States.

KANSAS CITY SOUTHERN RAILWAY COMPANY,
APPELLANT,

VS.

GUARDIAN TRUST COMPANY, APPELLEE.

KANSAS CITY SOUTHERN COMPANY, APPELLANT,

VS.

CENTRAL IMPROVEMENT COMPANY, APPELLEE.

Notice of Motion to Dismiss or Affirm, Motion to Dismiss or Affirm and Brief for Guardian Trust Company in Support of Motion.

EDWARD P. GATES,
WALTER C. CLEPHANE,
Solicitors for Guardian Trust Company, Appellee.

GEORGE H. ENGLISH, JR.,
Of Counsel.

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NUMBER 941.

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KANSAS CITY SOUTHERN RAILWAY COMPANY, APPELLANT,

VS.

GUARDIAN TRUST COMPANY, APPELLEE.

KANSAS CITY SOUTHERN COMPANY, APPELLANT,

VS.

CENTRAL IMPROVEMENT COMPANY, APPELLEE.

NOTICE OF MOTION TO DISMISS OR AFFIRM.

To Samuel W. Moore, Esq., Solicitor for Appellant, Kansas City Southern Railway Company, H. H. Crittenden, Receiver of Central Improvement Co., Frank Hagerman, Solicitor for Cambria Steel Company:

Please take notice that on Monday, April 27, 1914, at the coming in of the court, or in case the court shall not be sitting on that day, on the next motion day when the court shall be sitting, a motion to dismiss the appeal or to affirm the decree of the court below in the above entitled cause, will be submitted to the Supreme Court of the United States. Printed copy of such motion and brief to be submitted in support thereof is hereto attached and served upon you.

EDWARD P. GATES,
WALTER C. CLEPHANE,
Solicitors for Guardian Trust Company, Appellee.

GEORGE H. ENGLISH, JR.,
Of Counsel.

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CENTRAL IMPROVEMENT COMPANY, APPELLEE.

MOTION TO DISMISS OR AFFIRM.

Now comes appellee, Guardian Trust Company, and moves the court to dismiss the appeal in this case for want of jurisdiction, because the decree of the United States Circuit Court of Appeals for the Eighth Circuit, from which said appeal was taken, is in a cause in which the jurisdiction of said United States Circuit Court of Appeals for the Eighth Circuit, is final, in this, namely, that the jurisdiction of the Circuit Court (now District Court) in which this action originated was dependent entirely upon the diversity of the citizenship of the parties hereto, as appears from the original bill of complaint of said Cambria Steel Company herein filed. Or, if said appeal shall not be dismissed, then this appellee prays that the decree of said United States Circuit Court of Appeals of the Eighth Circuit, be affirmed on the ground that although if, in the opinion of this court, the record may show that this court has jurisdiction, it is manifest that said appeal was taken for delay only and that the question on which jurisdiction depends is so frivolous as not to need further argument.

EDWARD P. GATES,
WALTER C. CLEPHANE,
Solicitors for Appellee, Guardian Trust Company.

GEORGE H. ENGLISH, JR.,
Of Counsel.

NUMBER 941.

IN THE

Supreme Court of the United States.

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VS.

GUARDIAN TRUST COMPANY, APPELLEE.

KANSAS CITY SOUTHERN COMPANY, APPELLANT,

VS.

CENTRAL IMPROVEMENT COMPANY, APPELLEE.

BRIEF FOR GUARDIAN TRUST COMPANY IN SUPPORT OF MOTION TO DISMISS OR AFFIRM.

STATEMENT.

This is an appeal from the decision of the Circuit Court of Appeals of the Eighth Circuit.

The parties are numerous.

Those concerned here are the Cambria Steel Company (herein called the Cambria), the Kansas City Southern Railway Company (herein called the Southern), the Central Improvement Company (herein called the Central), and the Guardian Trust Company (herein called the Trust Company).

The Cambria is a corporation of Pennsylvania. All the other parties are corporations and citizens of Missouri, except one, a corporation of Kansas.

The original bill of the Cambria, exhibited September 6, 1900, averred that it was a judgment creditor of the Belt; that an indebtedness claimed by the Trust Company to be due the Trust Company from the Belt and secured by the deposit of collateral, would appear upon a true accounting to be invalid, and that the Trust Company would be indebted to the Belt; the bill prayed that the court decree that an accounting be taken between the Belt and the Trust Company and that the collateral and the proceeds of the accounting be subjected to the payment of the Cambria's debt.

Pursuant to the Cambria's prayer the Belt receivers exhibited an ancillary bill which (twice amended) set forth in detail the transactions complained of in the Cambria's bill and prayed for the cancellation of the indebtedness and the return of the collateral and for judgment for the amount to be found due on the accounting.

The Southern intervened averring that it was the purchaser of the Belt properties at a foreclosure sale and thereby became entitled to the collateral and the proceeds of the accounting. It also averred that the lands of the Central had been purchased with money of the Belt and that the equitable title thus created in the Belt passed to the Southern by the foreclosure sale; it therefore prayed for a decree requiring the conveyance to it of the Central properties.

The Trust Company's answer to the intervention of the Southern, set up that the Southern was liable for the Belt Company's debt in that the Southern Company was organized pursuant to a plan of re-organization of the Belt and other companies, whereby the Southern Company became successor in liability to the floating debt of the Belt Company to the Trust Company, which plan also provided expressly that one of the objects to be attained thereby was the payment of the floating debt.

Upon the accounting, the Master found that the Belt Company was indebted to the Trust Company; that the Trust Company was entitled to the collateral including the stock of the Central Company, but that the Southern Company was not liable to the Trust Company for the Belt indebtedness, and that the Southern Company was entitled to a conveyance of the property of the Central Company. The decree of the Circuit Court having been rendered in conformity with the master's report, the Trust Company appealed to the Circuit Court of Appeals for the 8th Circuit. The receiver of the Central Company also appealed. The Court of Appeals, after mature consideration and re-argument, in two opinions, held the Southern Company liable for the Belt indebtedness to the Trust Company, and held that until the Southern Company paid that debt, it was entitled to no relief respecting the Central Company's lands. From this decree of the Circuit Court of Appeals, the Southern Company prosecutes its appeal to this court. No other party appeals.

The question presented by the present motion is whether or not the case is one in which under the Statute (Act of March 3, 1891, Sec. 6, 26 Stat. L. 828), the decision of the Circuit Court of Appeals is final. We assert that it is, in that the sole ground of jurisdiction was the diversity of the citizenship of the Cambria Company and the defendants.

This question is to be determined upon the jurisdiction disclosed by the original bill of the Cambria Company. An abstract or digest of this original bill setting forth *verbatim* all the parts of the bill upon which any grounds of jurisdiction can be based is attached to this brief as Appendix "A." The bill itself appears at page 5 of the record.

For the convenience of the court there is also printed as Appendices "B" and "C" respectively to this brief, the prayers of the second amended and supplemental ancillary bill of the Belt and of the amended intervening petition of the Kansas City Southern. Said ancillary bill appears at page 456 of the record and the amended intervening petition of the Kansas City Southern appears at page 312.

For a more detailed statement of the facts and issues of the case, reference is made to the two opinions of the Circuit Court of Appeals, appearing respectively at pages 1163 and 1216 of the record. For the convenience of the court we have had printed copies of these opinions bound together, which are handed to the court with this brief.

It appears from the record, page 1250 and following, that after the decision of the Circuit Court of Appeals and nearly fourteen years after the original bill was exhibited, an application was made by the Cambria Company (evidently at the instigation of the Southern Company) for leave to amend the original bill by setting forth explicitly that relief was sought under the Federal Statute (Act of Aug. 1, 1888; Secs. 1 and 2, 25 Stat. L. 357), providing that the lien of the judgments of Federal Courts shall have only the extent of liens of judgments of State Courts in the same states. This application the Court of Appeals denied. But from the language of the application it is assumed by the appellee that it will be contended by the appellant in opposition to this motion that this record contains a Federal question growing out of the construction or application of that Statute and that therefore the jurisdiction of the Circuit Court of Appeals is not final, in that it rests not alone upon diversity of citizenship.

ARGUMENT.

The sole ground of jurisdiction appearing is diversity of citizenship.

It is, of course, difficult to present an argument in support of a negative proposition. We can only point to the original bill and assert that we are unable to perceive in it any question involving the construction or application of the Federal Statute mentioned in the proposed amendment, nor any ground of Federal jurisdiction save diversity of citizenship. To us it seems manifest that the claim that such a question is involved is merely an afterthought.

But while it is impossible to forecast the exact line of the argument which eminent counsel for the appellant may present, we confidently predict that such argument will be controlled by the following propositions:

(a) **The jurisdictional questions raised by this motion are to be determined by the issues raised and litigated under the original bill of complaint. Questions raised in subsequent pleadings, whether by answer, supplemental bill, or intervention, do not enlarge the jurisdiction.**

Denver v. *N. Y. Trust Co.*, 229 U. S. 123.
Shulthis v. *McDougal*, 225 U. S. 561.
Third St. etc. Ry. Co. v. *Lewis*, 173 U. S. 457, l. c. 460.
Huguley Mfg. Co. v. *Galeton Cotton Mills*, 184 U. S. l. c. 295.

(b) **The only ground of jurisdiction set out in the bill is diversity of citizenship. The ground pretended to exist by appellant can only be inferred argumentatively from statements in the bill. Jurisdiction cannot rest on any ground not affirmatively and distinctly set forth.**

Shulthis v. *McDougal*, 225 U. S. l. c. 569.
Hanford v. *Davies*, 163 U. S. 273.
Mountain View Mining Co. v. *McFadden*, 180 U. S. 533.
Bankers Casualty Co. v. *Minneapolis Co.*, 192 U. S. 371.
Devine v. *Los Angeles*, 202 U. S. l. c. 333.

(c) **Even if relief were sought under the Statute, no genuine controversy involving the construction or application of this Statute appeared in the case or appeared in the decision of the Circuit Court of Appeals appealed from.**

East Tenn. V. & G. Ry. Co. v. *Frazier*, 139 U. S. 288.
Roby v. *Colehour*, 146 U. S. 160.
Mobile Transfer Co. v. *Mobile*, 187 U. S. 479.
Winous Point Shooting Club v. *Caspersan*, 193 U. S. 189.
New York & N. E. Ry. Co. v. *Bristol*, 151 U. S. 555.
Southern Ry. Co. v. *Carson*, 194 U. S. 136.
Chapin v. *Fry*, 179 U. S. 127.

(d) **Even if there be read into the original bill or the subsequent bills, a ground for relief sought in establishing a lien upon lands of any of the parties, such relief was sought under general equitable principles and not under the Federal Statute, and hence there is no Federal question.**

Blake v. *Openhym*, 216 U. S. 322.
Telluride Power Co. v. *Rio G. Ry.*, 175 U. S. 639.
Rockhold v. *Rockhold*, 92 U. S. 129, 130.
United States v. *Thompson*, 93 U. S. 586, 588-9.
Chouteau v. *Gibson*, 111 U. S. 200, 201.

On the Motion to Affirm.

Even if some color be found by appellant for jurisdiction beyond mere diversity of citizenship, it is manifest that such question is one of no moment in the determination of this case. This conclusively appears from the assignments of error upon appeal to this court.

The assignments of error are attached hereto as Appendix "D."

These assignments of error were filed by the appellant *two days* after the motion of the Cambria Company made to the Court of Appeals for leave to amend the original bill, and while the subject of the jurisdiction was fresh in counsel's mind. The most careful scrutiny will fail to disclose in them a reference to any subject upon which the Federal jurisdiction would be invoked.

Obviously therefore, a question which the appellant does not seek to have reviewed by this court can be nothing more than frivolous.

Comments in Conclusion.

In its inception, as is manifest from the record and the decisions of the Court of Appeals, this case was nothing more or less than an ordinary resort to the equitable jurisdiction of the Federal Court with the view to compelling an accounting between the Belt Company and the Trust Company. That accounting terminated in favor of the Trust Company. No appeal was taken by any of the parties against whom the accounting was decided, and the validity of the indebtedness of the Belt Company to the Trust Company stands unquestioned.

The Southern Company became a voluntary intervenor in this case, and the sole question presented by its assignments of error is an endeavor to escape from the payment of the debts of the Belt Company for which it became liable. While the subject matter of the accounting was involved and intricate and while a record of unparalleled proportions was made in the presentation of these issues, it is obvious that the general purpose and object of the litigation was that of a simple proceeding for an accounting. No Federal question was actually involved; no genuine controversy over anything, save the general merits of an accounting suit, and the rights and equities arising therefrom was at any stage of the case litigated or submitted to any court.

It is most respectfully urged that one of the alternatives of the motion to dismiss or affirm be sustained, and that the Trust Company be permitted to have the relief to which it has so long been entitled and which it has been so long denied.

Respectfully submitted,

EDWARD P. GATES,
WALTER C. CLEPHANE,
Solicitors for Guardian Trust Co.

GEO. H. ENGLISH, JR.,
Of Counsel.

APPENDIX "A."

The Original Bill of the Cambria Steel Company.

The following is an abstract of the original bill of complaint of the Cambria Steel Company, the portions alluded to in this argument being quoted *verbatim* and the residue abstracted.

"In the Circuit Court of the United States for the Western "Division of the Western District of Missouri, "in Equity.

"Cambria Steel Company, Complainant,

vs.

"The Kansas City Suburban Belt Railroad Company, The "Union Terminal Railroad Company, Kansas City & "Independence Air Line, Guardian Trust Company, Mis-"souri Elevator and Terminal Company, Central Im-"provement Company, Second Street Improvement Com-"pany, Fairmount Amusement Company, and Northern "Town-site Company, Defendants.

"ORIGINAL BILL OF COMPLAINT.

"To the Judges of the United States Circuit Court for "the Western Division of the Western District of Mis-"souri, in the Eighth Circuit:

"Sitting in Equity.

"Your orator, the Cambria Steel Company, a corporation "organized and existing under and by virtue of the laws of "the State of Pennsylvania and a citizen of said State, brings "this its Bill of Complaint against the Kansas City Suburban "Belt Railroad Company, Kansas City and Independence Air "Line Guardian Trust Company, Missouri Elevator and "Terminal Company, Central Improvement Company, Second "Street Improvement Company, Fairmount Amusement Com-"pany, and Northern Town-site Company, each and all of "them corporations organized and existing under and by vir-"ture of the laws of Missouri and citizens and residents of "said State, and each of them having their principal office "and place of business at Kansas City in said State, and an in-"habitant of the Western Division of the Western District "thereof, and against The Union Terminal Railroad Com-"pany, a corporation organized and existing under and by "virtue of the laws of the state of Kansas and a citizen and "resident of said state, having its principal office and place of

"business at the city of Kansas City in said State, and an in-
"habitant of the First Division of the District of Kansas.

"And thereupon your orator complains and says that your "orator is a corporation duly organized and existing under "and by virtue of the laws of the State of Pennsylvania, hav-"ing its principal office in said state and is a citizen and resi-"dent of said state; that the defendants, The Kansas City "Suburban Belt Railroad Company (hereinafter called the "Belt Company), the Kansas City and Independence Air "Line (hereinafter called the Air Line), the Guardian Trust "Company (hereinafter called the Trust Company), the Mis-"souri Elevator and Terminal Company (hereinafter called "the Elevator Company), the Central Improvement Com-"pany (hereinafter called the Central Company), the Second "Street Improvement Company (hereinafter called the Second "Street Company), the Fairmount Amusement Company "(hereinafter called the Amusement Company), and the "Northern Town-site Company (hereinafter called the Town-"site Company), are each and all of them corporations or-"ganized and existing under and by virtue of the laws of "the State of Missouri; that each of them has its principal "Office in Kansas City in said State, and that each of them "is a citizen and resident of said State of Missouri and an "inhabitant of the Western Division of the Western District "thereof, and that the defendant, The Union Terminal Rail-"road Company (hereinafter called the Union Company), is "a corporation organized and existing under and by virtue "of the laws of the State of Kansas, has its principal office "in the City of Kansas City in the county of Wyandotte in "said state of Kansas, and is a citizen and resident of said "state of Kansas and an inhabitant of the First Division of "the District of Kansas."

Then follow averments of the change of name of the Trust Company; the procuring of judgment by the Cambria Company against the Belt Company, the issue of execution and its return *nulla bona;* and that the Belt Company is insolvent.

It is then charged that the Trust Company conceived the plan to cause to be constructed a large number of railroads in and about Kansas City and to dominate and control the actions of said railroads.

"That it was still further a part of said plan and purposes "of said Trust Company to organize a large number of auxil-"iary corporations, either in the way of construction com-"panies to construct and build said several lines of railroad "or in the way of companies to hold the legal title to lands, "buildings and other structures necessary to be used by the

"said railroad companies in their operations or for purposes "incident thereto, and to also cause various officers, agents, "employees and other representatives of said Trust Company "to become the officers and directors of each and all of the "said last mentioned construction and auxiliary companies "so as thereby to be enabled to completely dominate and control "the actions of the said construction and auxiliary companies "and of their several officers and directors."

The bill further charges that the Trust Company planned to foist upon the railroad or auxiliary companies all losses and to gather for itself all the profits of the enterprises; that the Trust Company assumed the position of trustee and agent in managing and disposing of the bonds, stocks, funds, etc., of the railroad and auxiliary companies.

That the Trust Company caused the Suburban Company to be organized to build a belt line about Kansas City; and caused it to execute a mortgage and issue bonds which the Trust Company sold; and caused the Terminal Company to be formed, to issue bonds and be consolidated with the Suburban Company; and caused the Union Company to be formed to build the part of the belt line in Kansas and to issue bond; that the Trust Company caused the Belt Company to be formed, to issue bonds and be consolidated with the Terminal Company; that the Trust Company caused its officers and agents to be elected officers of the Belt Company and thus dominated and controlled the Belt Company; that the Trust Company caused the Air Line Company to be created, to issue bonds which the Trust Company sold and dominated and controlled it; that the interest bonds of the Union Company, the Belt Company and the Air Line Company had not been paid and foreclosure proceedings were pending against them.

That the costs of the lines consolidated into the Belt Company did not exceed $1,700,000 and the companies delivered to the Trust Company bonds and stocks aggregating over $5,000,00; that the Trust Company has applied the excess in payment of its own commissions and services; that the cost of the Union Company's lines did not exceed $865,000 and the Trust Company received $4,000,00 of its stock and bonds applying the excess to payment of its services and commissions; that the cost of the Air Line did not exceed $200,000 and the Trust Company received its stocks and bonds to the amount of $850,000, applying the excess to its services and commissions.

That the Trust Company, though often requested, has failed to make a true and correct accounting; that upon a true accounting the Trust Company would owe the Belt Company a large amount, all of which is justly and equitably applicable to the orator's judgment against the Belt Company.

"Your orator further shows that in pursuance of its "aforesaid plans and purposes to organize auxiliary com- "panies for the purpose of taking and holding the legal title "to property necessary to be used in connection with the rail- "roads of the said several railroad companies above mentioned "or incidental thereto, and with the fraudulent intent and pur- "pose of preventing the properties so taken in the names of "said auxiliary companies, respectively, from being reached "by the creditors of said railroad companies or either of them "and particularly by the creditors of the said Belt Company, "said Trust Company did contrive the formation of the said "Elevator, Amusement, Central Second Street and Town-site "companies, respectively that the said Trust Company did "cause various of its officers, agents and employees to be "selected as the incorporators, stockholders, officers and di- "rectors of the said several auxiliary companies, and by means "thereof, did at all times dominate and control the manage- "ment of the said several auxiliary companies and the actions "of the stockholders and boards of directors thereof; that, as "your orator is informed and believes, all or substantially all, "of the moneys invested in the purchase, improvement and ac- "quisition of the several properties of the said auxiliary com- "panies and each of them, was paid and supplied by the said "Belt Company, and each and every one of the said auxiliary "companies was a mere device or 'dummy' contrived and pro- "vided by the said Trust Company as a means for taking and "holding the naked legal title to such properties as might be "vested in the said auxiliary companies, respectively, for the "use and benefit of the said Belt Company, and that, as to the "creditors of the said Belt Company and particularly as to "your orator, the properties and shares of stock of each and "every of the said auxiliary companies in equity belongs to "the said Belt Company and are chargeable with the lien and "payment of your orator's aforesaid judgment against the said "Belt Company; a list of real estate in the name of the auxil- "iary companies so far as known to complainant, is hereto "attached as "exhibit 2."

That the Trust Company, in 1897, contracted with railroads operating in Northwestern Missouri and Southwestern Iowa to provide them a railroad connection and entrance into Kansas City. This contract necessitated the construction of a railroad from Kan-

sas City to Pattonsburg, Missouri; that by its domination over the Belt the Trust Company caused the Belt to enter into a contract with the Northern Connecting Company (which the Trust Company had caused to be organized) to construct such road; and the Northern Connecting Company issued its bonds and stocks to pay for the construction which the Trust Company sold, charging the Belt Company with the moneys expended in construction and crediting it with the proceeds of the sale of said bonds and stocks, less such charges as the Trust Company saw fit to make for its services and commissions; that the result was a loss of over $300,000, which is justly chargeable to the Trust Company; that the contract was *ultra vires* the power of the Belt Company, and the act of the Trust Company in charging such loss to the Belt Company was fraudulent.

That the Trust Company caused to be organized the Kansas City, Pittsburg and Gulf Railroad Company under the laws of Missouri, to construct and operate a railroad from Kansas City to the Gulf of Mexico and caused it to issue bonds, the interest of which having defaulted, foreclosure proceedings are consequence pending in this court.

That the Trust Company, knowing that the default of the Gulf Company was inevitable and would result in defaults of payment of the interest upon the mortgages of the Suburban, Terminal, Union, Belt, Air Line and Northern Connecting Companies and of the auxiliary companies, planned to appropriate to itself the assets of said railroad and auxiliary companies and by its domination over the Belt caused the latter to go through the form of executing and delivering to the Trust Company a number of pretended promissory notes and of delivering to the Trust Company to secure the same all the bonds, stocks and other securities and all the movable personal property of the Belt Company.

Then follows a description of said notes and of the said property, and it is then charged said properties were taken possession of by the Trust Company fraudulently.

The Bill then proceeds with the averment that the Trust Company is insolvent and in process of liquidation; that it is threatening to sell the notes; that it has notified the Belt Company that it would sell the collateral.

"Your orator further shows that the property held in the "name of the Elevator Company, a corporation contrived by

"the said Trust Company as aforesaid, as a device and dummy "to take and hold the legal title to said property for and on "behalf of the Belt Company, and which property is equitably "and justly chargeable with the debts and liabilities of the "said Belt Company, consists, among other things, of three "(3) elevators known respectively as the "Star," "Eclipse," "and "Diamond" Elevators, which are located in the North-"eastern part of Kansas City, Missouri, and adjacent to the "railroad of said Belt Company, and that the same are neces-"sary and indispensable to a proper operation of said Belt "Company's property; that the property held in the name of "said Central Company consists, among other things, of va-"rious tracts of real estate in Kansas City, Missouri, ac-"quired for the use of the said Belt Line and necessary and "indispensable to such use, for station grounds, yards and "switches, side tracks and necessary buildings, and that said "property as hereinbefore alleged, is in equity the property "of the said Belt Line, the said Central Company being a mere "device and dummy contrived by the said Trust Company to "hold and carry the legal title thereto for the use and benefit "of the said Belt Line and its creditors; that the property held "in the name of the said Second Street Company consists, "among other things, of certain tracts of real estate in or near "Kansas City, Missouri, and used and indispensably necessary "to be used by the said Belt Company for depot grounds, nec-"essary buildings, right of way, yards, freight houses and "machine shops; that the said Second Street Company was "contrived by the Trust Company as aforesaid, as a mere de-"vice and dummy to take and hold the legal title to said prop-"erty for the use and benefit of said Belt Company, and that "the said property in equity belongs to the said Belt Company "and is chargeable with the debts and liabilities thereof, in-"cluding the judgment of your orator as aforesaid; that the "property and assets, the legal title to which is held by the "said Amusement and the said Townsite companies, re-"spectively, are likewise essential and indispensably necessary "to the successful operation of the property of the said Belt "Line, and that the said two last mentioned companies are "likewise devices and dummies contrived by the said Trust "Company for the purpose of taking and holding the legal "title to said assets and properties for the use and benefit of "said Belt Company as the equitable owner thereof, and that "such assets and property so held are equitably and justly "chargeable with the claims and demands of the creditors of "the said Belt Company, and particularly the judgment so "obtained by your orator as aforesaid."

The bill then charges that the management of the assets of the auxiliary companies is still under the domination of the Trust

Company and that it is necessary that receivers be appointed for the auxiliary companies and the railroad companies.

That the bill is brought both for the orator and all others similarly situated.

The prayer is:

(a) That an accounting be taken between the Belt and Trust Companies, in which the Trust Company be charged with all losses in its transactions with the Belt assets.

(b) That the Trust Company be decreed to hold the stock of the auxiliary companies and the bonds of the Northern Connecting Company in trust for the creditors of the Belt.

"(c) That the property and assets, the legal title to "which is held, respectively, by the said Elevator Company, "Amusement Company, Central Company, Second Street "Company, and Townsite Company be declared to be in equity "the property of the said Belt Company, and chargeable with "the lien and payment of the debts and liabilities of the said "Belt Company, and, particularly, the judgment aforesaid of "your orator."

(d) That the assets of the Belt be marshalled.

(e) That the rights of all persons in the assets of the Belt be adjudicated.

(f) That said assets and property be sold and the proceeds distributed among those found to be entitled thereto.

(g) For general relief.

The bill then prays for the appointment of receivers for the properties of the various companies and for an injunction against the Trust Company enjoining it from disposing of any of the notes and the property, and concludes with the prayer for a subpoena and waiver of answer under oath.

APPENDIX "B."

The prayer of the Second Amended and Supplemental Ancillary Bill of the Receivers of the Kansas City Suburban Belt Railroad Company (Rec. p. 532).

"In consideration whereof and for as much as your ora-"tors are remediless in the premises except in a court of equity, "your orators therefore pray the aid of this court;

"(a) That an accounting be taken of the various trans-"actions and dealings between the Trust Company and the Belt "Company; or by the Trust Company for the use and benefit "of and as trustee and agent for the Belt Company, and that "the Trust Company be required to pay the balance found to "be due by it, if any, upon such accounting; that in taking "such accounting all claims and demands alleged to be held "by the Trust Company against the Belt Company in Kansas "and Missouri, where the Trust Company used the Belt "Company simply as an instrumentality and agency for its own "use and benefit, be charged against the Trust Company, and "it be held liable for all losses incurred or claimed to have "been incurred by the Belt Company about the same.

"(b) That the said notes hereinabove described may be "found and decreed by this court to have been executed in "the fraudulent manner and for the fraudulent purposes above "set forth and without consideration; and that said notes may "be by this court directed to be surrendered up and cancelled, "and that each and all of the stocks, bonds and other securi-"ties, including the assigned account above mentioned, fraud-"ulently delivered to the Trust Company by its officers and "employes in the manner hereinabove set forth, may be or-"dered by this court surrendered and delivered up or re-"assigned to the Belt Company.

"(c) That each and all of the property purchased with "the money of the Belt Company and belonging in equity to "it, the legal title to which is held in the name of any of the "companies hereinbefore set forth, may be required by the "decree of this honorable court to be conveyed to the Belt "Company, or to its receiver for it.

"And your orators pray for a continuance of the writ "of injunction herein against the Guardian Trust Company, "its agents, servants and employes, restraining and enjoining "them and each of them from selling, transferring or in any "wise disposing of the said notes above mentioned and so "executed by the Belt Company to the Trust Company; and "from selling, transferring or in any wise disposing of the "said bonds and stocks and other property hereinabove de-

"scribed, delivered to said Trust Company as collateral se-"curity for said notes.

"And may it please Your Honors to grant unto your "orators the subpoenae of the United States of America issu-"ing out of and under the seal of this Honorable Court di-"rected to the Guardian Trust Company, the Missouri Eleva-"tor, Terminal Company, the Fairmount Amusement Com-"pany, the Central Improvement Company and Thomas T. "Crittenden, its receivers, the Northern Townsite Company, "and the Cambria Steel Company, the defendants herein re-"spectively, therein and thereby commanding them on a day "certain therein to be named and under a certain penalty to "be and appear before this Honorable Court then and there "to answer (but not under oath, an answer under oath be-"ing hereby expressly waived), all and singular the premises, "and to stand and perform and abide by such orders, direc-"tions or decrees as may be made in the premises, and as shall "seem meet and agreeable to equity and good conscience.

"And your orators will every pray.

"S. W. MOORE & T. R. MARKS,
"Solicitors for Complainants."

APPENDIX "C."

The prayer of the Amended Intervening Petition of the Kansas City Southern Railway Company (Rec. p. 337).

"Wherefore your intervener prays:

"a. For the judgment, order and decree of this court re-"quiring the Central Improvement Company and its Receiver "to convey to your intervener all the real estate or other prop-"erty standing in its name and to turn over to your intervener "all the moneys held by the Central Improvement Company, "or its Receiver, or owing to it, or them, arising from the "sale or the proceeds of said property;

"b. That the defendant, Guardian Trust Company, be "required to account for and pay to your intervener the value "of the steel rails and fastenings mentioned in paragraph "seven (7), together with interest thereon;

"c. That the defendant, Guardian Trust Company, be "required to account for and pay to the intervener the value "of the five thousand (5,000) shares of Union Terminal "stock, together with the value of four thousand nine hundred "and ninety-four (4,994) shares of the capital stock of the

"Air Line and also the value of the fourteen thousand nine "hundred and ninety-seven (14,997) shares of the capital "stock of the Terminal Company, together with interest there- "on.

"d. That the defendant, Guardian Trust Company, be "required to account for and pay to your intervener the value "of the bonds and stock of the Kansas City and Northern "Connecting Railroad Company mentioned in the preceding "paragraph nine.

"e. That the defendant, Guardian Trust Company, be "required to assign to your intervener the account of the Belt "Company against the Gulf Company mentioned in the fore- "going paragraph ten.

"f. That the defendant, Guardian Trust Company, be "required to release to your intervener all of the capital stock "of the Northern Townsite Company and that said Northern "Townsite Company and its receivers be required to convey "to your intervener all of the property held by said Northern "Townsite Company and its receivers, together with all the "moneys in their possession or owing to them as the proceeds "of the property formerly held by said Townsite Company "upon repayment to the Trust Company for such sum as the "court may find was contributed by said Trust Company for "the purchase of property taken in the name of the Townsite "Company.

"g. That the defendant, Guardian Trust Company, be "required to account for and pay to the intervener the amount "of the proceeds of the bonds of the Union Company diverted "by it from the purposes for which said bonds were issued, "as set forth in paragraph thirteen.

"h. And for such other relief as may be equitable and "just.

"SAMUEL W. MOORE,
"THOMAS R. MARKS,
"Solicitors for Intervener."

APPENDIX "D."

The Assignment of Errors of the Kansas City Southern Railway Company on this appeal (Rec. p. 1253).

"Now comes the appellant, The Kansas City Southern "Railway Company, and says that in the record and proceed- "ings herein, there is manifest error, and that the United "States Circuit Court of Appeals for the Eighth Circuit erred "in this, to-wit:

"1. In holding and deciding that The Kansas City "Southern Railway Company was liable for and required to "pay to the Guardian Trust Company the indebtedness of the "Kansas City Suburban Belt Railroad Company, to the "Guardian Trust Company.

"2. In holding and deciding that the rights and equities "of the Guardian Trust Company in the properties and capital "stock of the Central Improvement Company were prior and "superior to the rights and equities therein of The Kansas "City Southern Railway Company.

"3. In holding and deciding that the Guardian Trust "Company was not estopped by its participation in, and the "benefits received and retained by it from, and growing out of "the plan of reorganization involved herein, from maintain- "ing that The Kansas City Southern Railway Company was or "is liable for the indebtedness of the Kansas City Suburban "Belt Railroad Company to the Guardian Trust Company.

"4. In deciding and passing upon the issue of the al- "leged liability of the appellant for the indebtedness of the "Belt Company, in the absence of any exception taken be- "fore the master, or in the lower court, challenging the cor- "rectness of the finding of the master that the appellant was "not liable for such indebtedness.

"Wherefore, the appellant prays that said judgment and "decree of the said Circuit Court of Appeals may be reversed "in all things."

OCT 20 1915
JAMES D. MAHER
CLERK

—IN THE—

Supreme Court of the United States

OCTOBER TERM, 1915.

THE KANSAS CITY SOUTHERN RAILWAY COMPANY, *Appellant and Petitioner*,
vs.
GUARDIAN TRUST COMPANY, CENTRAL IMPROVEMENT COMPANY, CAMBRIA STEEL COMPANY, and KANSAS CITY SUBURBAN BELT RAILROAD COMPANY, *Respondents*.

No. 85.

BRIEF OF THE KANSAS CITY SOUTHERN RAILWAY COMPANY, APPELLANT AND PETITIONER.

SAMUEL UNTERMYER,
SAMUEL W. MOORE,
Solicitors for Appellant and Petitioner.

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—IN THE—

Supreme Court of the United States

OCTOBER TERM, 1915.

THE KANSAS CITY SOUTHERN RAILWAY COMPANY, *Appellant and Petitioner,*
vs.
GUARDIAN TRUST COMPANY, CENTRAL IMPROVEMENT COMPANY, CAMBRIA STEEL COMPANY, and KANSAS CITY SUBURBAN BELT RAILROAD COMPANY, *Respondents.*
No. 85.

BRIEF OF THE KANSAS CITY SOUTHERN RAILWAY COMPANY, APPELLANT AND PETITIONER.

THE MAIN QUESTION PRESENTED BY THIS RECORD.

The main question involved is whether, in a reorganization of several allied railway companies, participated in by both bondholders and stockholders, the respondent, Guardian Trust Company, herein referred to as the Trust Company, which was a stockholder and bondholder in several, and an unsecured creditor of one of the subsidiary companies involved, could, as such unsecured creditor, impose a liability for that debt on the new company, The Kansas City Southern Railway Company, herein referred to as the Southern Company, based upon the alleged fraudulent character of the reorganization plan, under the rule of *Northern Pacific*

Railway Company v. *Boyd*, 228 U. S., 482, *in the face of the following conceded facts*:

(a) The Trust Company, as bondholder and stockholder of five of the companies involved in the reorganization, had previously exchanged its securities ($1,294,841.00 par value) *under the reorganization plan and agreement* (its stock alone amounting to $517,199, which, but for the plan, would have been a total loss), and received, in lieu thereof, *and still retains* $865,927.70 par value of the stock (of which $407,606.70 par value was received in exchange for stock of the old companies), and $614,981.50 par value of the bonds of the new company, or an aggregate of $1,480,909.20 par value of the securities of the new company.

(b) The Trust Company, at the time it became a party to the reorganization plan and as a part of the reorganization agreement, had executed a covenant in consideration of the stocks and bonds of the new company which it received under the plan in exchange for its bonds and stocks of the old companies by which the appellant claims that it *agreed* not to hold the new company for the debt of the old companies, the covenant being, in substance, as follows:

> No right is conferred nor any trust, liability, or obligation is created by this agreement or the plan, or is assumed hereunder by or for any new company, in favor of any creditor or any holder of any claim whatsoever against the said companies (including the Belt Company), with respect to any moneys paid to or received by the Committee, *or with respect to any property acquired by purchase at any foreclosure sale*, or with respect to any other matter or thing.

(c) The appellant purchased the properties involved under decrees of foreclosure and sale, rendered by the circuit court of the United States, which purported to convey to it the properties free and clear of claims or liens, but without prejudice to the rights of the Trust Company in certain particulars.

(d) The property of the Kansas City Suburban Belt Railroad Company, herein referred to as the Belt Company, (which was the debtor of the Trust Company), was encumbered with a mortgage of $1,000,000, in which the Trust Company was the trustee; its property was sold to the Southern Company at foreclosure

sale for that amount, and the proceeds of the sale were paid in and distributed under the order of the court. The "fair market value" of the property of the Belt Company at the time of the foreclosure sale and during the reorganization was litigated in the case at bar, and the master found (this finding is not conceded, but it is established by the record, pp. 852, 853) *that the value of its property at that time did not exceed the mortgage indebtedness.* The Trust Company did not except to this finding, nor assign it as error.

The circuit court of appeals (reversing the lower court which affirmed the findings of the master) holds that, under these circumstances, the Trust Company may hold the Southern Company for the debt of the Belt Company and is, therefore, entitled to judgment against the Southern Company in an amount exceeding $800,000 on that account.

Among other important questions raised for determination by this court, is the question whether the after-acquired property clauses contained in the mortgages of several of the reorganized companies, operated to impress an equitable lien upon certain real properties located at Kansas City, standing in the name of a dummy corporation so as to vest the title to the properties in the Southern Company, as the purchaser at foreclosure sale.

AN OUTLINE OF THE PLEADINGS AND A BRIEF HISTORY OF THE CASE.

1. *The bill of the Cambria Company.* A consideration of this bill and the issues made by it are only important *for the purpose of ascertaining if the bill sets forth a distinct ground of Federal jurisdiction independent of that of diversity of citizenship.*

In September, 1900, the Cambria Company filed a creditor's bill (Rec., 3-27), based upon the judgment rendered in its favor by the United States circuit court for the Western District of Missouri against the Belt Company, and brought against the Belt Company, the Trust Company, and others, asserting that *the lien of this judgment* attached to the equitable title of the Belt Company to certain real properties, the *legal title* to which was held or claimed by the Trust Company and certain other companies, and

seeking a foreclosure of this *judgment lien* and a sale of the real properties *thereunder;* and also demanding an accounting between the Belt Company and the Trust Company, and seeking to subject certain stocks and bonds, held by the Trust Company as collateral, to the payment of the complainant's judgment, if, as a result of the accounting, the alleged indebtedness should be canceled and the collateral should be released. The litigation of the accounting feature was carried on under the ancillary bill of the Belt Company and its receivers, *infra,* as provided by stipulation (Rec., 942-944). The finding and decree of the circuit court were against the complainant on the issues made by the bill, and no appeal was taken. A more detailed reference will be made hereafter to the bill of the Cambria Company in considering the motion made by appellee to dismiss this appeal.

2. *The ancillary bill of the Belt Company and its receivers.* The Belt Company and its receivers, by direction of the court (Rec., 29), and by stipulation (Rec., 890), which provided that there should be an accounting between the Belt Company and the Trust Company, filed an ancillary bill and amendments (Rec., pp. 97, 202, 392) against the Trust Company and others, seeking an accounting as between the Belt Company and the Trust Company, and the release of the collateral held by the latter. A great number and variety of issues were involved in the accounting and a vast amount of testimony taken. The report of the master upon this issue is contained in the record (pp. 575-735). The decree of the circuit court (Rec., 903), eliminated three items from the account and gave judgment (Rec., 906), in favor of the Trust Company and against the Belt Company in the total sum of $639,658.86. No appeal was taken by the Belt Company or its receivers for the reasons hereafter stated.

3. *The intervening petition of the Southern Company.* The questions raised by this appeal have *solely* to do with the issues made by the *intervening petition* of the Southern Company, and the Trust Company's *answer* thereto.

In February, 1905, it was stipulated (Rec., 164), that the Southern Company should be made a party to the cause either as joint complainant or by bill of intervention, as it might elect, and that the testimony theretofore or thereafter taken in the case should be considered in support of the issues made. Its intervening pe-

tition, *which was in the nature of an original bill,* was immediately filed (Rec., 166), and afterwards amended by stipulation (Rec., 267-269), in which it alleged that it was the purchaser at foreclosure sales under foreclosure decrees, of the United States circuit court at Kansas City, of the railroad properties of the Belt Company, the Kansas City, Pittsburg & Gulf Railroad Company, hereinafter referred to as the Gulf Company, and the Kansas City & Independence Air Line, herein referred to as the Air Line; that the mortgages executed by those companies upon their properties respectively contained after-acquired property clauses, and that the liens of said mortgages attached in equity to the property and collateral held by the Trust Company as security for the alleged indebtedness of the Belt Company to it; and the Southern Company prayed that the collateral be awarded to it. In particular, the Southern Company alleged that certain railroad terminal properties in Kansas City, Missouri, and in Kansas City, Kansas, had been purchased by the Belt Company, Gulf Company, and the Air Line, with moneys contributed by those companies respectively for terminals and rights of way needed by them respectively, the legal title being taken, for convenience, in the name of the Central Improvement Company, herein referred to as the Central Company, which it was charged had been organized solely for the purpose of conveniently holding the legal title to such properties. The Southern Company averred that the lien of the mortgages of the Belt Company, the Gulf Company, and the Air Line, attached in equity to these properties at the times of their purchase and acquisition, and that the equitable title thereto had passed to it as purchaser under the foreclosure sale, and it demanded either a conveyance of the properties to it, or a return to it of the capital stock of the Central Company, which was held by the Trust Company as a part of its collateral security.

4. *The answer of the Trust Company to the intervening petition of the Southern Company.* The answer of the Trust Company sought to invoke the rule of *Northern Pacific Railway Company* v. *Boyd,* 228 U. S., 482, and asserted that the reorganization of the Gulf Company, Belt Company, and their associated companies, resulting in the organization of the Southern Company, was a *fraudulent scheme* which made the Southern Company liable for the debt of the Belt Company, *notwithstanding the fact that*

the Trust Company was a party to the reorganization plan and benefited therefrom to the extent of approximately $1,500,000, *in securities of the reorganized company, issued to it under the plan, which it still retains.*

The Trust Company, in its answer filed in March, 1905, (Rec., 186), alleged (Rec., 199-201), that a reorganization plan, contemplating the reorganization of the Gulf Company and its allied companies, had been prepared and promulgated by a reorganization committee; that such plan contemplated the deposit with the committee of the stocks and bonds of the companies involved in the reorganization, and the organization of a new company, to-wit, the Southern Company, which should issue its stocks and bonds in exchange for the stocks and bonds of the old companies in certain specified proportions; that the exchange of stocks resulted in the stockholders of the Belt Company securing a large amount of the stock of the Southern Company, which was alleged to be more valuable than the Trust Company's claim against the Belt Company, and it was averred that said scheme legally implied the payment by the Southern Company of the Trust Company's claim against the Belt Company.

5. *The master's report and final decree rendered by the lower court.* The master's report (Rec., 575-887), was filed in May, 1910. It occupies 316 pages of the record. The accounting between the Belt Company and the Trust Company is disposed of at pp. 575-735. The report upon the issues made by the intervening petition of the Southern Company is disposed of at pp. 735-887. The general conclusions of the master are stated at pp. 887-888.

The finding of the master was against the Cambria Company upon its original bill and was in favor of the Belt Company and its receivers upon three items in the account (Rec. 887), and against them as to all other items. The master found (Rec., 887), that the Southern Company was entitled to a conveyance to it of the lands of the Central Company; and that the Southern Company did not, by reason of the reorganization plan, or otherwise, assume or agree to pay, or become liable for, the indebtedness of the Belt Company to the Trust Company.

The Trust Company filed exceptions to the master's report (Rec., 892). It excepted (Rec., 893-894), to the *inclusion* in the report of *any finding* on the issue of the liability of the Southern

Company, but did not except to the *correctness* of the finding itself. The Southern Company, the Belt Company, and its receivers, also excepted to the master's report. The final decree was entered by the lower court on June 25, 1910 (Rec., 903), overruling the exceptions of the Trust Company, the Southern Company, the Belt Company, and its receivers (Rec. 913), rendering a judgment in favor of the Trust Company and against the Belt Company in the sum of $639,658.86, and finding that the Southern Company did not assume or agree to pay or become liable for the indebtedness of the Belt Company, and also directing the Central Company to convey certain specified lands to the Southern Company.

6. *The appeal to the Circuit Court of Appeals.* The Trust Company was allowed an appeal without supersedeas to the circuit court of appeals for the eighth circuit on August 10, 1910, (Rec. 920). An appeal was allowed on behalf of the Central Company on August 19, 1910 (Rec. 922), but on October 8, 1910 (Rec. 934), the orders allowing the appeal of the Central Company and approving its supersedeas bond were set aside and vacated by the circuit court upon the ground that counsel purporting to represent the Central Company were not, in fact, authorized to appear for or represent it.

The record, on appeal to the circuit court of appeals, contained only the pleadings, the report of the master, and certain orders and stipulations. It did not contain any of the evidence.

7. *Proceedings in the Circuit Court of Appeals.* The case was argued before the court of appeals composed of a circuit judge and two district judges, in May, 1911. Three questions only were raised by the assignments of error of the Trust Company: *first*, that the issue of the liability of the Southern Company for the debt of the Belt Company was *not* in the case and should *not* be decided; *secondly*, that the decree was erroneous in requiring the Central Company to convey the specified property to the Southern Company; and *thirdly*, that the court erred in requiring one-third of the costs to be paid by the Trust Company (Rec. 915). There was no assignment of error directed to the *correctness* of the finding on the liability issue; in fact, counsel for the Trust Company insisted that the liability issue was not in the case and should not

be decided. They said in their return to a rule to show cause, etc., (Rec. 970):

> That by reason of the former decision of this court, and by reason of the state of the pleadings and record in the cause from which this appeal is taken, *the question of the personal liability of The Kansas City Southern Railway Company for the debt of the Belt Company is not in issue and cannot be determined upon this appeal.*

In June, 1911, the judges of the circuit court of appeals advised that they thought the liability issue was one of the issues made by the pleadings (Rec. 974), and asked counsel to brief that question so that the court might determine whether it could consider the liability issue under the state of the record, and if so, whether there was plain error in that regard which the court could notice of its own motion. Briefs were accordingly filed on December 1, 1911, and the case was submitted thereon, oral argument being denied.

On October 22, 1912, the circuit court of appeals handed down the opinion reported in 201 Fed., 811 (Rec. 986), reversing the decision of the circuit court and directing the lower court to enter a specific decree in favor of the Trust Company and against the Southern Company for the entire indebtedness of the Belt Company. In January, 1913, a re-argument was had, and on December 2, 1913, a second opinion was handed down, adhering to the former conclusions of the court (Rec. 1027), reported in 210 Fed., 696.

8. *Appeal to this court.* On January 24, 1914, the circuit court of appeals allowed the Southern Company's appeal to this court (Rec. 1057), fixing the supersedeas bond in the sum of $600,000, which has been duly given.

9. *Application to this court for a writ of certiorari.* The Trust Company filed herein its motion to dismiss the appeal, claiming that the decision of the court of appeals was final. Out of an abundance of caution, and in accordance with the settled practice where the right to appeal to this court from a court of appeals is controverted, the Southern Company submitted to this court its application for a writ of *certiorari* at the same time that the Trust Company's motion to dismiss was submitted, and the motion and the application were by this court considered together.

10. *This court's action upon the Trust Company's motion to dismiss, and upon the Southern Company's application for certiorari.* On May 11, 1914, this court, having had under consideration the motion of the Trust Company to dismiss the appeal, and also the application of the Southern Company for a writ of *certiorari,* announced the following opinion:

> In view of the serious nature of the question of jurisdiction, the court does not desire to pass upon the same without the benefit of an oral argument, to be heard when the case is regularly reached on the call. The motion to dismiss is hence postponed to the hearing on the merits; and, being of opinion that the nature of the case is such as to authorize the granting of the writ of *certiorari* which is applied for, in the event it develops on the hearing that there is no jurisdiction to review the same, the application for the writ of *certiorari* is therefore also postponed to the hearing.

The case is here for argument on the merits, as well as upon the motion to dismiss and the application for *certiorari.*

STATEMENT OF FACTS.

1. *The state of the record.* The record brought by the Trust Company to the circuit court of appeals did not contain any of the evidence which consisted of over 34,000 pages of testimony (Rec., 579). The appeal to this court brings up the identical record which was before the circuit court of appeals. The record contains the pleadings, the report of the special master and certain orders and stipulations.

2. *The relations of the Trust Company to the Belt Company and the other companies involved.* The Trust Company was incorporated in 1889 under the laws of Missouri as the Missouri, Kansas & Texas Trust Company, and so continued until 1899, when by proper statutory proceedings its name was changed to Guardian Trust Company (Rec., 583). Its president was Arthur E. Stilwell, the dominant and controlling influence in the operations of the Trust Company and of all of its subsidiary and auxiliary companies. It was engaged in the business of organizing companies and acting as their financial agent in the sale of their stocks and bonds (Rec., 593). The bulk of its business was the promotion of the railroads involved in this reorganization and

their subsidiary companies (Rec., 594). Originally the business of the Trust Company was that of building houses and making loans upon real estate, but subsequently it developed broadly into a general promotion business; the profits of the business being through the acquirement of securities for its services, and on account of the securities bought by it and resold, and also through the commissions, bonuses, earnings or profits on securities it might sell for the subsidiary companies. *The bulk of the Trust Company's business arose out of its original promotion projects, and the handling of the securities of the companies promoted* (Rec., 600).

The Trust Company secured control of the Suburban Company (see Rec. 578, 579 for abbreviations of corporate names), in 1890 and elected its nominees as its officers and directors (Rec., 609). The Trust Company afterwards caused to be incorporated the following companies involved in this reorganization, paying the incorporation fees and naming its own employees and officers as the officers and directors of the new company:

Consolidated Terminal Railway Company, (Rec., 610).
Kansas City & Independence Air Line, (Rec., 610).
Union Terminal Railway Company, (Rec., 610).
Kansas City, Pittsburg & Gulf Company, (Rec. 611).
Port Arthur Channel & Dock Company, (Rec., 597).

The Belt Company was formed in 1892 by the statutory consolidation of the Suburban Company and the Consolidated Company (Rec. 609).

Also, among others (about 40 in all, Rec., 597), the following companies, subsidiary and auxiliary to those above named, were organized by the Trust Company:

Kansas City Terminal Construction Company, (Rec., 608).
Missouri Elevator & Terminal Company, (Rec., 610).
Central Improvement Company, (Rec., 611).
Fairmount Amusement Company, (Rec., 611).
Kansas City Connecting R. R. Co., (Rec., 611).
Northern Townsite Company, (Rec., 611).
State Realty Company, (Rec., 611).
Second Street Improvement Company, (Rec., 612).
Kansas City Fruit, Auction & Cold Storage Company, (Rec., 612).

> "The Trust Company," says the master (Rec., 643), "was *the central and important and controlling corporation* of the aggregation, known as the Stilwell companies, and which in large measure was influential in *bringing into existence* all the corporations, whose operations are involved in complainant's bill and which were substantially *financed* by it."

The books, bond and stock ledgers, stock certificate books and minute books of Belt, Union, Consolidated, Air Line, Connecting Company and other companies, as well as their securities until disposed of, were kept in the Trust Company vaults (Rec., 605, 599). Their minute books were O. K'd by employees of the Trust Company (Rec., 610-611). Their officers were substantially identical (Rec., 609-612).

Stilwell was president of the Trust Company (Rec., 594), the leading officer of the other companies (Rec., 593), and "all powerful" (Rec., 595), in all of them.

> "It cannot be questioned," says the master (Rec., 644), "that A. E. Stilwell was the influential and dominant personage, who more than any other person connected with it, outlined the *policies* of the Trust Company, and likewise, with E. L. Martin, and other associates, *practically determined those of the railroad companies interested in this accounting.*"

When a new project was contemplated Stilwell, Martin and others would cause a new company to be formed, provide officers for it from among themselves and their associates in the Trust Company, acquire the necessary property for it, the Trust Company advancing the money for that purpose when necessary, direct the issue of stocks and bonds by the new company, and the Trust Company would take an active part in marketing them, paying itself commissions, bonuses and trustee fees for its services; in other words the Trust Company undertook the general financing and managing of those companies, and in view of their relations with the Trust Company, they were usually operated in a manner following the policy desired by the Trust Company, the books of a majority of the companies, including the books of the Belt Company and the Central Company, being kept in the office of the Trust Company and by its clerks (Rec., 598-599). The offices of the Belt Company were in the same building adjoining the Trust

Company's office from 1894 to 1900 (Rec., 602). The Trust Company financed the Gulf Company in the same general manner that it financed the other railroads (Rec., 608).

Substantially all the officers and directors of the Belt Company from the date of its creation by the consolidation of the Suburban Company and the Consolidated Company in 1892, were officers, directors and employees of the Trust Company (Rec., 756, 609).

The Trust Company was the *trustee in the mortgage* of the Suburban Company (Rec., 737), a co-trustee with the Provident Company in the mortgage of the Consolidated Company (Rec., 738), a trustee in the mortgage of the Air Line (Rec., 739), a co-trustee with the Provident Company in the mortgage of the Union Company (Rec., 739), and a co-trustee with the State Trust Company in the mortgage of the Gulf Company (Rec., 740), all of which mortgages have been foreclosed in actions to which the Trust Company was a party, and the titles conveyed pursuant to foreclosure sale have been acquired by the Southern Company.

3. *The situation at the time of the appointment of receivers for the Gulf Company in April,* 1899. The Gulf Company had constructed a line of railroad which (with a Louisiana company and a Texas company organized to comply with local laws), extended from Kansas City, Missouri, to Port Arthur, Texas, a distance of approximately 777 miles. The terminals at Port Arthur, consisting of a ship canal, docks, wharves, etc., were owned by the Port Arthur Channel & Dock Company. The terminals at Kansas City were owned and controlled by the Belt Company and its allied companies, which were the Union Terminal Company, the Consolidated Terminal Company, and the Air Line.

The bond issues of those companies were as follows (Rec. 818):

Gulf Company	$24,000,000
Belt Company	1,000,000
Union Terminal	2,000,000
Consolidated Company	750,000
Air Line	300,000
Dock Company	1,635,000
Total	$29,685,000

The issued and outstanding shares of stock were as follows:

Gulf Company	$24,000,000
Belt Company	4,750,000
Dock Company	1,575,000
Total	$30,352,000

The Belt Company owned the stock of the Air Line, Union Terminal Company, and Consolidated Company.

The Trust Company had been, in a large measure, influential in bringing into existence all of these companies, in financing them, providing officers for them from its own directorate and employes, and had marketed their securities (Rec. 643-645). The officers of the Trust Company were, at all times, officers of these railway companies, and in a position to control them and their properties (Rec. 609-612). These companies as well as the Trust Company, were known as "Stilwell Companies," having been organized and, to a certain extent, controlled, by Arthur E. Stilwell (Rec. 643-644).

On April 1, 1899, (Rec. 825) the Gulf Company defaulted in the payment of its interest and receivers were appointed. At that time, the indebtedness of the Belt Company to the Trust Company was $360,000 (Rec. 668). This indebtedness was made up almost entirely of losses sustained by the Belt Company under a construction contract for the construction of the Northern Connecting Railroad extending from Kansas City north to Pattonsburg, Mo. (Rec. 668-669), which contract it is claimed by the appellant, was not only *ultra vires,* but was made between the Belt Company and the Northern Connecting Company at the instance of the Trust Company, through its control of both of those companies by means of its interlocking directorates. This reference is made to the origin of the indebtedness only for the purpose of making it plain that it is not entitled to any special or particular equities, by reason either of the relationship of the parties or the character of the indebtedness.

4. *The Reorganization Plan and Agreement.* A reorganization committee was formed in June, 1899, a few months after the appointment of receivers for the Gulf Company. A reorganization agreement dated June 14, 1899, which authorized the com-

mittee to formulate and to put into effect a plan of reorganization, was executed by the Trust Company and other depositing security holders of the Gulf Company and its allied companies (Rec. 814). The committee published a plan dated August 17, 1899, and this was afterwards modified in some particulars and was known as the modified plan of November 7, 1899, which was made effective. The Trust Company was one of the depositaries under this plan. An analysis of the plan will be found in the report of the master (Rec., 813-824). In a general way, and so far as is deemed material here, the plan contemplated:

(a) The purchase of the property of the *Gulf Company* by the committee, at foreclosure sale, and the conveyance of it by the committee, together with the stocks and bonds of the terminal companies (if sufficient of their securities should be deposited to warrant their retention) to a new company to be organized, which should issue certain securities to be disposed of as therein specified (Rec. 815).

(b) By this means the new company would own the main line of the Gulf Company and the stocks and bonds of the terminal companies, all of which would go under the mortgage of the new company. Provision would be made for the payment of the floating debt and car trust obligations, for working capital, for future requirements, for the reduction of fixed charges within the probable income of the property, and for control of the reorganized company through a voting trust until it should be in a satisfactory financial position (Rec. 815).

(c) If the securities of the terminal companies should not be deposited in sufficient amount, then other terminals at Kansas City and Port Arthur would be used, under arrangements already made in that behalf. It was intended, as soon as practicable, that the new company should acquire the properties of the terminal companies in fee, and bring them directly under the lien of the mortgage (Rec., 815).

(d) Payment of $10 per share was required as a condition of participation in the plan by stockholders of the Gulf Company (Rec. 815).

(e) The new company should issue $30,000,000 par value 3 per cent bonds, $21,000,000 par value of preferred stock, and $30,000,000 par value of common stock (Rec. 816, 817), which should be disposed of as follows (Rec. 816-820):

BONDS.

For exchange for old securities	$23,197,500	
For cash requirements	3,000,000	
For future requirements	3,802,500	
Total		$30,000,000

PREFERRED STOCK.

For exchange for old securities	$17,417,500	
For cash requirements	3,000,000	
Unappropriated balance	582,500	
Total		21,000,000

COMMON STOCK.

For exchange for old securities	$29,561,250	
Unappropriated balance	438,750	
Total		30,000,000

(f) The ratio of exchange of old securities for new securities should be as follows (Rec. 819-820):

For Gulf Company bonds, 75% of new bonds and 50% of new preferred stock.

For Gulf Company stock, 100% of new preferred stock.

For Belt Company bonds, 133% of new bonds and 25% of new preferred stock.

For Belt Company stock, 25% of new preferred stock and 75% of new common stock.

For Union Terminal bonds, 100% of new bonds and 25% of new preferred stock.

For Consolidated Terminal bonds, 100% of new bonds and 25% of preferred stock.

For Air Line bonds, 100% of new bonds and 25% of new preferred stock.

For Dock Company bonds, 50% of new bonds, 50% of new preferred stock, and 50% of new common stock.

For Dock Company stock, 75% of new common stock.

(g) In order that the depositing security holders might know what it was proposed to do with the securities reserved for *cash requirements*, the plan set forth (Rec., 820), that it was expected to realize the sum of $5,900,000 for this purpose, made up as follows:

By sale of $3,000,000 first mortgage 3 per cent bonds and $3,000,000 preferred stock	$3,500,000.00
From payments of $10 per share by participating stockholders or the syndicate	$2,400,000.00
Total	$5,900,000.00

Then it was set forth that the probable disposition of this fund of $5,900,000 to be raised for *cash requirements* would be as follows (Rec. 821-822):

For payment of car trusts and interest adjusted to date of payment, say	$1,900,000.00
For payment of floating debts	475,000.00
For payment of receiver's certificates	800,000.00
For payment first mortgage coupons, due April 1, 1899	575,000.00
Working capital and expenses of reorganization	2,150,000.00
Total	$5,900,000.00

The purpose of the appropriation of $475,000 for the payment of floating debt was to provide for

> —all kinds of items which the committee deemed necessary to take care of *so as to secure absolutely the first mortgage lien on the properties transferred to the Southern Company* (Rec. 860).

The master summarizes the testimony in respect to the floating debt provision as follows (Rec. 860-861):

> The testimony of Shipley, Smith, Petitt, Pam, Harrity, Sielcken and Hecksher, members of the reorganization committee, and found in Vol. 57 of the Record, is to the effect that the $475,000 appropriated, as above stated, for the payment of floating debts, was a lump sum set aside by the committee to make provision for the payment and discharge of such obligations as the committee might find necessary to discharge *in order to relieve the properties, to be included in the Southern mortgage, from any liens claimed thereon or from*

any interference as a matter of business policy, and that said $475,000 was simply an estimate or reservation to cover such charges, and further, that at no time did the committee, in making such estimate, contemplate or include therein the indebtedness of the Belt Company to the Trust Company, but the contracting parties to the reorganization plan and agreement, made an express provision, intending to exclude, and *excluding*, the Trust Company or any other creditor of the constituent companies from enforcing against the new company to be formed, any right of action which such creditors might have had against the old companies.

The estimates of probable expenditures for the purposes indicated in the foregoing list, aggregating $5,900,000, including the estimate of $475,000 for the payment of floating debt, were largely exceeded, the amount actually expended by the committee and by the Southern Company in the payment of floating debt of all the companies of the character above described was $1,164,172.56. The master, speaking of the provision for the cash requirements of the new company in the amount of $5,900,000, above referred to, says (Rec. 859-860):

> From the undisputed facts in the record, it can hardly be claimed that the Trust Company, or any other unsecured creditor of the Belt Company, had a direct interest in the floating debt reservation provision of the reorganization plan, for the carrying out of such provision was clearly within the discretionary powers of the reorganization committee in every way whatever. The committee was fully authorized to do as they thought best in respect to paying off such indebtedness as, in their judgment, was necessary or expedient, in furtherance of the purposes of the reorganization plan and agreement; and, hence it appears, in Ingel's testimony (Rec. Vol. 56, pp. 34354 to 34380) and particularly in his exhibit 192, in Vol. 56, pages 34357 to 34368, that the Committee and the Southern Company together paid out in connection with the obligation of $5,900,000 set out in the modified plan of reorganization, the following amounts:
>
> Car Trust certificates; amount called for under the plan. $1,900,000
>
> Amount actually paid out by Committee and Southern Company $2,192,580.40

First mortgage coupons and *ad interim* interest; amount called for in the plan....	575,000	
Amount actually paid out by Committee		891,913.41
Receivers' certificates; amount called for under the plan.	800,000	
Amount actually paid out by Committee and Southern Company		821,543.74
Appropriated to floating debt; amount called for in modified plan	475,000	
Amount actually paid out by mittee and Southern Company . .....-...		1,164,172.56

This statement shows that, as to each item, the amount paid out largely exceeded the original estimate, and, that the joint payments of the Committee and Southern Company, on account of the floating debt appropriation, exceeded the estimate to the extent of $689,172.56. This fact certainly shows the exercise of the widest discretionary power as to shaping up the details of the reorganization scheme for the benefit of the new security holders and one of the largest of which is the Trust Company, as it received bonds and stock of the Southern Company in exchange for, approximately, $850,000, par value, of the securities of the old companies. (Rec. Vol. 49, pp. 29972 to 29974.)

In other words, the Trust Company, presumably, received its proportionate benefit from this large expenditure in payment of what are called the *floating debts*, but which in reality consists of all kinds of items, which the committee deemed necessary to take care of, so as to secure absolutely the first mortgage lien on the properties transferred to the Southern Company

(h) The reorganization agreement of June 14, 1899, which was duly executed by the Trust Company, contained the following covenant (Rec. 823):

> No right is conferred, nor any trust, liability or obligation (except the agreements herein contained in favor of the holders of certificates of deposit hereunder), is created by this agreement or the plan, or is assumed hereunder, or by or for any new company in favor of any bondholder or any other

creditor or any holder of any claims whatsoever against the said companies, nor in favor of any company now existing or to be formed hereafter (whether such claim be based on any bonds, coupon stocks, securities, lease, guaranty or otherwise) with respect to any security deposited under this agreement or any moneys paid to or received by the Committee or by the depositor hereunder, *or with respect to any property acquired by purchase at any foreclosure sale*, or with respect to any new certificates to be issued hereunder, or with respect to any other matter or thing.

Other provisions of the contract will be referred to in the course of the argument.

5. *The Trust Company's participation in the reorganization.* On July 26, 1900, the Trust Company received from the depositary *under the reorganization plan*, the following securities of the Southern Company:

$614,981.50 par value of bonds.
$295,196.70 par value of preferred stock.
$570,731.00 par value of common stock.

$1,480,909.20

These securities of the Southern Company were issued in exchange for and upon surrender by the Trust Company of the following securities of the old companies owned by it (Rec. 867):

$ 410,000 par value Union Terminal bonds.
42,000 par value Air Line bonds.
325,000 par value Channel and Dock bonds.
642 par value Gulf bonds.
1,327 par value Gulf stock.
76,972 par value Belt stock.
438,900 par value Channel and Dock stock.

$1,294,841.00

In speaking of this exchange of securities by the Trust Company, and its attitude toward the reorganization plan, the master says (Rec. 825):

> The Trust Company, being the owner of a large amount of these securities, including those of the Belt Company, deposited them with the reorganization committee, and obtained in lieu thereof certain stocks and bonds of the South-

ern Company, which the Trust Company still retains. The Trust Company was also one of the depositaries in the modified plan of reorganization, and it is claimed by intervenor and it is abundantly shown by the testimony in the record, that the respondent actively co-operated in the reorganization of the Belt properties, and induced its correspondents to accept said plan and to exchange their securities for the Southern Company securities.

The master also says (Rec. 869):

> It is not controverted that the Trust Company, a depositary in the reorganization plan, co-operated with the committee, and used its influence, by correspondence and otherwise, to induce other bondholders and stockholders to deposit their securities with the committee, as will more fully appear by reference to letters, passing between it and the committee, during the reorganization period, and found in Vol. 55, pp. 34488 to 34564 of the record. The respondent was well acquainted with the purposes of the reorganization scheme, and with such knowledge, entered into the same, depositing its own securities and exchanging them for the new Southern securities, and advising others to make like exchanges.

The market quotations of the stock of the Southern Company are not in the master's report, but both parties, for the purposes of argument, have resorted to the daily market reports. The following is quoted from page 80 of the brief of the Trust Company entitled "Reply of Guardian Trust Company to Kansas City Southern Railway Company's argument and brief on reargument," previously filed by it in the court of appeals, and now on file with the clerk of this court:

> The lowest price quoted on the preferred stock of the Southern Company during the year 1900, (that being the time of the exchange of securities) was $27.50 per share, and the highest price during that year was $40 per share; the lowest price quoted on the common stock during the same period was $7 per share, and the highest $14.75 per share.
>
> The range of prices at the date of the acquisiton of the Belt properties by the Southern through the foreclosure (during year of 1901) was as follows:
>
> Lowest price of sale of preferred stock, $35 per share.
> Highest price of sale of preferred stock, $49 per share.
> Lowest price of common stock, $13.50 per share.
> Highest price of common stock, $25 per share.

6. *Foreclosure and sale of the property of the Gulf Company.* A decree of foreclosure and sale was rendered in the Gulf receivership proceedings on February 5, 1900, and the property was sold by the master on March 19, 1900, and purchased by the Southern Company, which entered into possession April 1, 1900, and has continued to operate the property since that time (Rec. 825). The Southern Company also became the owner of the old securities which had been surrendered to the reorganization committee by the holders thereof for exchange for the stocks and bonds of the Southern Company which it had issued as provided in the plan. The property formerly owned by the Gulf Company and also the stocks and bonds of the old companies, including those of the Belt Company, were mortgaged by the Southern Company to secure its new bonds. The Southern Company, by virtue of its ownership of a majority of the stock of the Belt Company, elected its nominees as officers of the Belt Company on April 1, 1900, and thereafter the affairs of that company were managed by its own officers until receivers were appointed for the Belt Company in September, 1900, as hereafter stated (Rec. 779, 838).

The reorganization committee completed its labors and made its settlement with the Southern Company in October, 1900.

7. *The foreclosure of the mortgage of the Belt Company and the sale of its property.* From April 1, 1900, the Belt Company continued to own and manage its own properties with its own officers until September, 1900, when receivers were appointed for it by the federal court at Kansas City, and the receivers continued to manage its affairs until January, 1902, when it was taken over by the Southern Company as a purchaser at the foreclosure sale (Rec., 825). The mortgage of the Belt Company was in the sum of $1,000,000 (Rec., 737). At the foreclosure sale in November, 1901, the upset price was $1,000,000 and the property was sold for that amount, the Southern Company becoming the purchaser and entering into possession in January, 1902. On April 27, 1903, the court, in the foreclosure proceeding, rendered a deficiency judgment for $242,854.40 against the Belt Company (Rec. 838). The floating debt of the Belt Company on February 1, 1900, was approximately $900,000 (Rec. 755), its indebtedness to the Trust Company at that time being something like $500,000, the greater part of which had been

incurred on account of the contract entered into by the Belt Company for the construction of the Connecting Railroad (Rec. 755).

The Trust Company was a trustee in the mortgages of the Gulf Company, the Belt Company, and others. It was a party to the foreclosure suit against the Belt Company, but by stipulation, the foreclosure decree provided that it should be without prejudice to the rights of the Trust Company (Rec. 867), the provision of the decree in that behalf being as follows:

> This decree is entered on the express condition, to which the complainant has assented, that it shall be without prejudice to and shall not bar the right of the Guardian Trust Company, or its receiver, to plead and insist in any litigation now pending or hereafter brought, that the Kansas City Southern Railway Company, by virtue of the manner in which it was organized, or for any other reason, is legally or equitably liable for and bound to pay the unsecured debts of the Kansas City Suburban Belt Railway Company, either in full or to pay them to the extent of the value of any property heretofore acquired by it from the Kansas City Suburban Belt Railway Company or that hereafter may be acquired by it from said company by virtue of these foreclosure proceedings; and without prejudice to the right of said Guardian Trust Company or its receiver, to plead and insist, in any pending litigation or litigation hereafter brought, that the members of the Reorganization Committee of the Kansas City, Pittsburg & Gulf Railroad Company assumed to pay and are liable to pay the unsecured debts of the Kansas City Suburban Railroad Company existing at the time the alleged reorganization was undertaken.

The conclusions of the master, to which no exceptions were filed by the Trust Company, with respect to the effect of the foreclosure sale of the properties comprising the Belt system and now owned by the Southern Company, are stated by him to be as follows (Rec. 852-854):

> 1. The foreclosure sales were legally made, and the Trust Company, though a party to the foreclosure proceedings, has not at any time objected to the *regularity* thereof, or the *sufficiency* of the amounts received for the properties sold.
>
> 2. In the record there is no *direct* testimony by either party showing the actual, fair, reasonable value of said properties at the time of, or prior to, the foreclosure of the mortgage liens thereon.

3. The union, or combination, of all the roads of the Belt system and Gulf road into the Southern Company, pursuant to the reorganization scheme, created and gave to the reorganized system a *much larger value* than was the aggregate value of all said roads as separate institutions, managed as they were prior to the date they were sold to the reorganization committee; and, further, that by reason of the additional value given to said properties as parts of the reorganized railroad system, the Southern Company was enabled to issue its thirty million dollars of bonds, twenty-one million of preferred stock, and thirty million of common stock, the whole aggregating eighty-one million, par value, and approximately, more than four times the amount paid by the committee for said properties at the foreclosure sales thereof.

4. There is no sufficient proof, in the record, showing what was the market or other value of the stocks and bonds of the Southern Company, which were given to the stockholders of the Belt Company, though such values, if shown, would be no fair criterion on which to base the actual value of the Belt property, turned over to the Southern Company, in the manner hereinabove stated.

5. If respondent's contention is correct to the effect that there was a consolidation, *de facto*, by which the intervenor became liable for the Belt indebtedness, still *there is no proof in the record to show that the Belt properties, sold under the mortgage foreclosures, were worth anything in excess of what they brought at the sale;* and in the absence of such proofs, the master finds that the amount, for which they were, respectively, sold, *was and is their fair, market value at that time.*

6. There is *no evidence* in the record showing *actual frauds* either at or in the inception of the reorganization scheme, or in any proceeding thereunder; including the foreclosures of the mortgage liens on the properties sold and the conveyance to the Southern Company.

7. That, for their mutual protection and self interest, the bondholders interested in all the railroad companies involved, had the right to combine together for the purpose of acquiring all the properties thereof, and then uniting them in one system, and without consulting either the stockholders or creditors of the constituent companies owning such railroads; and, furthermore, that it was competent for the bondholders, in furtherance of their own business interests, to use the stocks and bonds of the new company as they saw

fit, *provided, that it is not shown that in so doing, it was part of their scheme to give something of value to the stockholders that should have gone to the creditors.*

8. It is not shown in the record that the reorganization scheme *in any way* deprived the unsecured creditors of any rights they would otherwise have had in case such scheme had never been consummated. There is no pretense that the Trust Company was prevented from bidding on, or buying, said properties, because of any secret understandings, nor is there any satisfactory proof in the record to the effect that the conduct of the Trust Company, in respect to said foreclosure sales, was in any wise changed or altered on account of the reorganization plan and agreement.

8. *The properties of the Central Improvement Company.* These properties are dealt with by the master in his report (Rec., 781-804), the conclusion of the master being that the Southern Company is entitled to the conveyance of the properties standing in the name of the Central Company. This finding was affirmed by the lower court, and reversed by the court of appeals.

The Central Company was organized in 1895 for the purpose of holding the legal title to certain real estate needed for right of way purposes by the Gulf Company, Belt Company, Air Line, and Union Terminal Company (Rec., 783). The lands so acquired were necessary for those companies respectively for right of way and terminal purposes. Prior to the organization of the Central Company, another corporation,—the State Realty Company—had been used for the same purpose (Rec., 784).

The moneys employed for the purchase of Central properties were furnished by the company in whose interest the property was purchased. As the Belt Company, for illustration, required a piece of right of way for terminal property, the same was purchased, the Belt Company furnishing the money, and the title was taken in the name of the Central Company. In this way, properties were purchased and conveyed to the Central Company, the aggregate considerations paid being as follows (Rec., 786):

Belt Company	$129,571.50
Air Line	16,104.41
Gulf Company	23,673.89
Total	169,349.60

As one of the railroad companies would purchase property and pay for the same, taking the title in the name of the Central Company, the latter would issue its capital stock to the company furnishing the money in an equal amount par value. In this way there were issued (Rec., 787):

To the Belt Company	817 shares
Gulf Company	234 shares
Union Terminal	334 shares
Air Line	22 shares
Total	1,407 shares

It is important to remember that the railroad of the Belt Company was constructed with the proceeds of its bonds. At the time of the execution of its mortgage, *in which the Trust Company was the trustee*, the Belt Company possessed nothing except its charter. Provision was made in the mortgage for the issue of bonds from time to time as the work of construction progressed, and the road as constructed came under the mortgage by virtue of the after acquired property clause. As each bond of $1,000 was issued the Belt Company acquired an equivalent of property of the value of $1,000 which came under the mortgage; as the indebtedness secured by the mortgage increased, the physical property increased in a corresponding amount. This is stated in the finding of the master (Rec., 737), as follows:

> In the building of the railroads belonging to the Suburban Belt, and its allied railroad companies, a mortgage was first placed upon the properties of each road, respectively, and providing, generally speaking, that the mortgage lien should cover the railroad constructed, and to be constructed and properties described in such mortgage, then owned or controlled by such road, and also such properties as should thereafter be acquired by it. The object being to secure the money required to build the roads from the sale of the bonds secured by the mortgage, it was important, as a protection to future bondholders, that the proceeds of the bond sales should be used for and go into the building of the respective railroads, or in the purchase and acquirement of properties connected with the building or operation thereof, or otherwise for the betterment of the railroad company, so as thereby to enhance in value the security for its bonds. In other words, that the properties then owned or possessed, as well as those

> thereafter to be acquired, should alike come under the lien of the mortgage by virtue of the "after-acquired property" clause thereof, as the purchasers of the bonds were bound to know the contents of the mortgage securing the same, and had the right to rely thereupon, and to claim all the benefits to be legitimately obtained by reason of its provisions.

The mortgages of the other companies contain substantially the same provision (Rec., 737).

While there is nothing to positively identify the money which was used by the various companies in the purchase of the Central Improvement properties, yet it is a fair presumption that the funds came from the proceeds of the mortgage bonds, inasmuch as that was the only source from which moneys for construction purposes were derived.

The plan employed was for the Belt Company, Gulf Company or the Air Line, as the case might be, to designate the real estate which it needed for its own purposes, and in reality to make the purchase, paying the purchase money and taking the title in the name of the Central Company. As the master found (Rec., 801):

> Each road interested in these respective tracts of land indicated what it desired the Central Company to buy, how much was to be paid for the tract bought and generally arranging the details of such purchase.

The State Realty Company, prior to the organization of the Central Company, had been used for these purposes, but upon the organization of the Central Company the properties were transferred to that company, and as the master found (Rec., 784):

> The Realty Company billed these properties so conveyed to the Central Company at their actual cost; that is to say, at their original purchase price, with all taxes and other fixed charges thereon, and thereupon the Central Company charged the amounts thus fixed against each property to the various railroads along whose route the lands thus acquired laid, and against those charges the Central Company credited itself with its own capital stock, which it issued out of its treasury to the railroad companies, respectively.

It stands admitted that the properties of the Central Company were paid for with the funds of the Belt Company, Gulf Company and Air Line, respectively, and that each company furnished the

money for the purchase of such of the lands as it needed for its own purposes. The Central Company acquired no other property, did no other buisness and had no other excuse for its existence than to hold the title of properties purchased in this way. The master found (Rec., 784):

> From time to time the Central Company made other purchases and the cost of such lands was in each instance charged to the particular railroad purchasing the same, the custom of conducting the business being to make a requisition upon such road for the necessary funds to pay for the land purchased, and the railroad company would respond by issuing to the Central Company its voucher, covering the cost of the land and the expenses incident to the purchase, such as attorney's fees, recording fees, abstract, etc., and all such advances made by any railroad company on account of land purchased were credited to it by the Central Company and for the exact amount of which the stock of the Central Company was issued to such railroad company.

The officers of the interested companies, who were, in the main, officers of the Trust Company, in the practical administration of their affairs, treated the Central Company as a trustee holding these various properties in trust for the use and benefit of the railway companies respectively furnishing the money for their purchase. The auditor of the Belt Company, in December, 1899, writes to the auditor of the Trust Company (Rec., 790), enclosing certain statements, a portion of the latter being "Statement of real estate, title to which is in the name of the Central Improvement Company and purchased by them *for the use* of the Union Terminal Railroad and the Kansas City Suburban Belt Railroad Company and the Kansas City & Independence Air Line."

Counsel for the Trust Company, who was also a director of the Central Company, in April, 1895, addressed a letter to the State Realty Company (Rec., 790), containing the following:

> The Central Improvement Company has now been incorporated for the purpose of taking title to all of such tracts of land and reimbursing you through the Suburban Belt for all moneys expended in reference to such purchases *for the benefit* of said railroad company.

Moneys advanced by the Belt Company to the Central Company were charged by the Belt Company to "Right of Way" (Rec., 791), the voucher bearing the following notation:

> The ownership of this stock represents right of way lands and lands adjacent to our right of way occupied by this company. *As this is practically a part of the cost of road* the above account is opened to show it as such.

The correspondence between the tax commissioner and the assistant treasurer of the Central Company (Rec., 792), contains a list of property, the title to which is in the Central Company, described as "property held *in trust* for the Kansas City Suburban Belt Railroad Company."

The master finds (Rec., 801):

> It has been conclusively shown by the proofs in this cause that each real estate purchase was made *at the direction of the railroad company interested in such purchase*, and not by the directors of the common interests of all of the stockholders alike, as should have been done in case all such stockholders were intended to be interested alike in each and all of the purchases so made.

The real purpose in the organization of the Central Company was that it should hold the title to properties for the various railway companies so that they might be handled without having to secure their release from the mortgages of the companies respectively (Rec., 801).

The master says (Rec., 803):

> The theory upon which the conclusion of the master is reached is based upon the principle that the Central Company was simply used for the purpose of holding the *titles* to the particular properties *belonging to each one of these railroads*, and to all intents and purposes, *it acted as a trustee*, and was *not a beneficial owner*, the intention being, as already stated, to place these properties beyond the lien of the general railroad mortgage, which covered after-acquired properties.

It is well enough to bear in mind the circumstances under which the Trust Company acquired the stock of the Central Company as security for the indebtedness of the Belt Company:

(a) The Trust Company was the *trustee in the mortgage of the Belt Company* (Rec., 737, 740), and as such it was its duty to insist that the rights of way and terminal properties acquired by the Central Company, but *owned in equity by the Belt Company*, (or the stock of the Central Company which represented these properties), should be subjected to the lien of the Belt Company's mortgage for the protection of its bondholders.

(b) The officers of the Trust Company were also the officers *in control of the Belt Company* (Rec. 754).

(c) The Trust Company, through its managing officers, knew prior to April 1, 1899, (the date of the receivership of the Gulf Company), that the Gulf Company would default in its interest; that receivers would be appointed for it, and that a reorganization plan would probably be adopted, and that the appointment of Gulf receivers would likely mean that the *Trust Company would not thereafter be as potential in the affairs of the Belt Company as it had formerly been* (Rec., 754-756).

(d) The Trust Company thereupon formed a plan to get possession of all the personal property of the Belt Company to secure its antecedent debt and, acting under instructions from Mr. Stilwell, president of the Trust Company, got from the Belt Company all its available securities, *against the protest of the Treasurer of the Belt Company* (Rec., 605). This action was taken in view of the probable loss of the controlling influence of the Trust Company in Belt matters, by reason of the proposed reorganization (Rec., 754, 756).

(e) The books of the Central Company were kept in the offices of the Trust Company, and the clerical work was done by the clerks of the Trust Company (Rec., 605).

The situation with respect to the property of the Central Company may be briefly summarized by the statement that as the Gulf Company, the Belt Company, and the Air Line Company needed terminal properties in Kansas City, they bought and paid for such as they needed, taking the title in the name of the Central Company in the mistaken belief that that course would prevent the mortgages of those companies from attaching to the properties; the officers and employes of all the interested companies regarded the properties, notwithstanding the

fact that the title was thus placed, and stock of the Central Company issued to each company in an amount corresponding to the purchase price, *as still remaining the property of the Company which had paid for it;* that when the Gulf Company became bankrupt and receivers were appointed, the Trust Company saw its control of the Belt Company slipping away and accordingly, by "strong arm" methods, it stripped the Belt Company of all its personal property, including the stock of the Central Company.

On December 9, 1901 (Rec., 143), the Trust Company filed its answer to the ancillary bill of complaint, in which it frankly admitted that the Belt Company and the Gulf Company were in equity the beneficial owners of all the property of the Central Improvement Company, the allegation being as follows:

> It is true that a corporation known as the Central Improvement Company was organized, but it was done at the instance and by the procurement of the Belt Company and the Kansas City, Pittsburg & Gulf Railroad Company for the purpose of securing and acquiring title to various tracts of land in and about Kansas City, *which were needed for the use of the said railroad companies.* It is true that the Suburban Belt Railroad Company furnished some of the money to be paid upon the purchase price of the lands bought by the Central Improvement Company; it is also true that the Kansas City, Pittsburg & Gulf Railroad Company advanced some money for the same purpose; upon such money being furnished by the said railroad companies, the said Central Improvement Company issued to the Belt Company 1,120 shares of its capital stock, and also issued certain shares of its stock to the Kansas City, Pittsburg & Gulf Railroad Company on account of the money furnished by it; all or practically all outstanding stock of the Central Improvement Company has been issued to and is held by the Belt Company and the Kansas City, Pittsburg & Gulf Railroad Company, or their assigns. That by reason of the fact that the Belt Company and the Kansas City, Pittsburg & Gulf Railroad Company, or their assigns, hold all of the stock of the Central Improvement Company, *they are in equity the beneficial owners of all of the property of the Central Improvement Company,* subject, however, to any liens thereon for unpaid portions of the purchase price thereof. That the Trust Company has not now and never has had any interest in the *property* of the Central Improvement Company, except that it holds a mortgage on a certain piece of the

property owned by the said Central Improvement Company, to secure certain promissory notes aggregating the principal sum of $5,000.00, which mortgage was a subsisting lien upon the property at the time the Central Improvement Company bought it, and which mortgage was subsequently purchased and is now held by the Trust Company.

SUPPLEMENTAL STATEMENT TO CORRECT CERTAIN MISCONCEPTIONS ON WHICH THE COURT OF APPEALS BASED ITS DECISION.

We wish to direct attention to various statements, conclusions and inferences contained in the second opinion of the court of appeals, which we respectfully submit are unwarranted or erroneous. (The references are to the pages of the opinion in 210 Fed. 696.)

1. The court reaches the conclusion which we believe to be wholly erroneous, that a recovery by the Trust Company in this case will work no hardship to any bondholder or stockholder of the Southern Company. It says, p. 720:

> Third, neither the Southern Company nor its stockholders nor bondholders will suffer any injury by proof of the truth in this transaction and the granting to the Trust Company of the equitable relief to which it was entitled in 1901. They took to themselves by a breach of trust and a transfer fraudulent as to creditors by the foreclosure sale on December 31, 1901, an equity in the property of the Belt Company of a value in excess of the amount of the Trust Company's claim, then about $360,000, which belonged to that company, and they have held and enjoyed it ever since. *Each stockholder and bondholder has had and still has the benefit of his just proportion of that equity.* If now the Southern Company is required to restore that equity or its value in 1901, with interest from that date, *each stockholder and bondholder will lose the benefit of its just proportion of that equity which it wrongfully holds and nothing more.* Nor will the Trust Company secure or retain any unjust share or advantage. While it will receive the value of that equity, to which it as a creditor of the Belt Company was entitled in 1901 with interest, its stocks and bonds issued by the Southern Company

> will lose the benefit of that equity in the same proportion as will the stocks and bonds of others. The stocks and bonds of the Trust Company and of all the other holders of stocks and bonds in the Southern Company will be diminished in value in the exact proportion by which they were enhanced in value by the wrongful appropriation of the equity of the Trust Company in the property of the Belt Company which the Southern Company wrongfully took and holds, and the justice and equity to all which should have been done many years ago will now as nearly as practicable be administered.

Is it correct to say that the Trust Company by a recovery in this case will not "secure or retain any unjust share or advantage?" Let us see what it secures and retains:

(a) It received $865,927.70 par value of common and preferred stock of the Southern Company, of which $407,606.70 par value has been issued in exchange for *stock* in the old companies, all of which would have been a total loss but for the reorganization plan. This latter amount, upon the court's theory, is a trust fund for the payment of creditors, which has been "fraudulently and by a breach of trust" diverted from them to the Trust Company.

(b) It received $614,981.50 par value of bonds and $458,321 par value of stock of the Southern Company, aggregating $1,073,302.50 par value, in exchange for its *bonds* of the old companies, which were of the aggregate par value of $777,642. We know that the new securities thus received were of greater value than the old securities, although the increased value cannot be accurately measured, and that the Trust Company received the benefit of the enhancement in value, for the master says, p. 858:

> The union or combination, of all the roads of the Belt system and Gulf road into the Southern Company, pursuant to the reorganization scheme, created and gave to the reorganized system a much larger value than was the aggregate value of all said roads as separate institutions, managed as they were prior to the date they were sold to the reorganization committee.

And now, in addition to the foregoing, the Trust Company by the decree of the court of appeals is to receive from the Southern Company its debt against the Belt Company in full with in-

terest to date, and we are told that this will not give any unjust share or advantage to the Trust Company, nor work any injustice to the Southern Company or to its shareholders.

Let us see if this bears the test of analysis. The committee pays to the Belt stockholders for their stock, $4,750,000 par value of Southern stock, which, for convenience in illustration, we will assume is ten per cent of the entire capital stock of that company. Its value, at $10 per share, as found by the court, is $475,000. The Trust Company's debt against the Belt Company is $360,000.

How are stocks and bonds of all the other holders of stocks and bonds—that is the other ninety per cent—*enhanced in value* by the transaction? True, the company has acquired an equity valued at $475,000 (subject to claims of creditors), but it has paid for it in its own stock of the par value of $4,750,000, of the actual value of $475,000. The other stockholders—the ninety per cent—have gained nothing by the transaction, for while $475,000 has been added to the assets of the Southern Company the latter, by the issue of its own stock, has paid for it dollar for dollar. The holdings of the other stockholders are certainly not *enhanced* in value.

If the Southern Company had purchased the securities of the Belt Company, giving in payment therefor its promissory notes for the exact amount of the purchase price, $475,000, the value of the stock of the Southern Company could not be said to be *enhanced* thereby.

Prior to the acquisition by the Southern Company of the stock of the Belt Company the "other stockholders" held *all* of the outstanding stock of the Southern Company, that is, they held one hundred per cent of stock interest, representing all the reorganized properties (except the Belt), which may be represented by one hundred per cent of value. Then ten per cent in value (the Belt property), is added, making the aggregate one hundred and ten per cent of the former value; and ten per cent additional stock is issued making the total outstanding stock one hundred and ten per cent of the original issue. The "other stockholders" have gained nothing either in par value or actual value of their interest.

How can it be "that the stocks and bonds of the Southern

Company were enhanced in value by the wrongful appropriation of the equity of the Trust Company in the property of the Belt Company?" The utmost that can be said is that certain property was acquired by the Southern Company, but that by the issue of additional Southern stock the proportional interest of each stockholder in the entire Southern property was decreased in a corresponding ratio.

What happens when a recovery is had in this case? The Southern Company is required to pay over $800,000 to the Trust Company and the burden falls equally on *all* the stockholders of the company.

The holdings of the "other stockholders" whose securities have never been "enhanced" by the original acquisition of the equity of the Belt Company, will most certainly be "diminished" in value because of the payment of over ninety per cent of the judgment will fall upon them. The situation will then be that the Southern Company has purchased property of the value of $475,000 and paid for it by the issue of its capital stock of an equal value; the title to the property so purchased fails through the assertion of a superior title or equity, and the loss falls on *all* the stockholders.

The obvious equity of the situation is that when the title fails the loss should fall on those who received the consideration, and they are the stockholders of the Belt Company, of whom the Trust Company was one.

Nor is it perceived how the value of the bonds of the Southern Company could have been enhanced in value "by the wrongful appropriation of the equity of the Trust Company." The bonds were secured by the securities of the Belt Company, and the foreclosure proceedings only operated to change an equitable title into a legal title.

2. The court finds that the creditors' equity diverted to stockholders was of the value of $475,000, that the debt of the Belt Company to the Trust Company was $360,000 at the time, and that therefore, the Trust Company must be paid in full *regardless of the rights of other creditors of the Belt Company*. It says at page 707:

> The master's report also shows that the Southern Company gave $1,187,500 of its preferred stock and $3,562,500

of its common stock to the stockholders of the Belt Company for their equitable interest in the property of that company, that at the same time stockholders of the Gulf Company paid, and the Southern Company received $10 per share in cash and an equal number of shares of the stock of the Gulf Company for tens of thousands of shares of the Southern Company's common stock. That stock must therefore have been worth at least the $10 cash per share which was paid for it, and it was worth as much more as the value of the stock of the Gulf Company. The preferred stock of the Southern Company could not have been worth less than its common stock. The Southern Company therefore paid in value at least $475,000 for the equitable interest of the stockholders of the Belt Company in its property when it gave them $4,750,000 of its preferred and common stock for their stock in that company. But the equitable interest of the creditors in the property of the Belt Company was superior to that of the stockholders, and its value could not have been less, and was undoubtedly greater than the $475,000. *That interest was therefore worth more than enough to have paid the $360,000 which the Belt Company owed to the Trust Company, and the Southern Company cannot escape liability on the ground that it was worthless.*

But according to the president of the Belt Company (Rec., p. 755)—there was no testimony to the contrary—"the total debts of the Belt Company were approximately $900,000."

How are the claims to the extent of $900,000 to be paid *in full* by the restoration of the diverted creditors' equity of $475,000? It would have required the issue to Belt stockholders of $9,000,000 par value of stock of the Southern Company, of the value of $10 per share to have realized enough to pay all the creditors in full; but in fact only $4,750,000 par value of Southern stock of the aggregate actual value of $475,000 was issued in exchange for Belt securities.

The only fund to which unsecured creditors of the Belt Company could resort, according to the court's finding, was $475,000, and, as this was not sufficient to pay all unsecured creditors in full, the obvious equity was to distribute it among them *pro rata*.

But the court, with only $475,000 available for the payment of $900,000 of unsecured debts of the Belt Company, proceeds to direct the payment of the Trust Company's debt *in full* in disregard of the claims of other unsecured creditors.

Upon the court's theory of this case the equity of the Trust Company would be satisfied by awarding it a *pro rata* share of the total fund available for unsecured creditors. The decree of the court, in order to be consistent with the reasoning of the court, should have been for approximately one-half of the Trust Company's claim instead of for the full amount, which would make a difference of some $400,000. Any other conclusion involves the assumption that Peter is to be robbed to overpay Paul.

3. The court in speaking of the sufficiency of the exceptions of the Trust Company to the report of the master, says at page 699:

> From all the facts pertinent to the issue which are set forth in many printed pages of his report, the master deducted this decisive conclusion: "That the Southern Company is not liable in any way for the floating indebtedness of the Belt Company." *To this conclusion the Trust Company excepted* on the ground that in view of other conclusions which the master reached adverse to it, it was unnecessary for him to determine that issue.

It is respectfully submitted that the Trust Company did *not* except "to this conclusion." It significantly refused to do so and based its appeal upon a theory that was inconsistent with such an attitude. The Trust Company excepted to the *inclusion* in the master's report of any "reference to or recommendation concerning the question of the liability of the Southern Company for said floating indebtedness of the Belt Company" for certain specified reasons. It insisted that there was no such issue before the court.

The exceptions of the Trust Company (omitting that portion referring to the property of the Central Company), are here reproduced (Rec. 892-894):

> And now comes Guardian Trust Company, defendant, and *excepts to the report* of the Honorable Shannon C. Douglass, Special Master, filed in this cause on the 21st day of May, 1910, and for cause for exception shows: * * *
>
> Second: The master has in said report stated (on page 461 thereof) as follows: That the Southern Company is not in any way liable for the floating indebtedness of the Belt Company, *whereas the master in his report should have omitted reference to or recommendation concerning the question of the liability of the Southern Company for said floating indebtedness of the Belt* for the following reasons:

(a) The master having found and stated in his report that by reason of the laches of the Southern Company and the Statute of Limitations said intervening bill was not maintainable against this defendant, therefore the said bill should be dismissed as to each and all the parts thereof.

(b) That said finding is unnecessary for the determination of this cause upon the facts found by him, and its *incorporation in a decree* in this cause would be *unnecessary* and immaterial.

(c) That *by reason of the fact and for the cause that no relief was asked by this defendant against said intervenor* and because the master found that the other defenses interposed by this defendant to the intervention of the Southern were valid, such finding is *unnecessary* and immaterial in the rendition of the decree in this cause.

(d) That in a cause determined on a supplemental petition in this cause exhibited by said intervenor and said Belt Company against this defendant, which was finally decided by the United States Circuit Court of Appeals for the Eight Circuit in a cause entitled *Guardian Trust Company, Appellant,* v. *Kansas City Southern Railroad Company, et al. Appellees,* numbered 2827, and reported in Federal Reporter, volume 171, page 43, the law of this case was enunciated by said United States Circuit Court of Appeals that the *personal liability of said intervenor was not in issue in this cause* and that said matter was for the determination of the Circuit Court of Jackson county, Mo., *in three causes then and now pending in said Circuit Court of Jackson County, Missouri,* at Kansas City, and that said ruling and determination is binding upon all the parties to this cause, and upon this court and upon the master appointed by this court. Said finding and decision of said circuit court of appeals is as follows:

> The liability of the Southern Company to pay the debts which the Trust Company alleges in the actions at law it has promised to pay, is not in issue and cannot be determined in the suit in equity, and the state court has no jurisdiction over and cannot interfere in those actions *in personam* with the specific property which is the subject of the litigation in the federal court.

(e) That by reason of the law and the evidence, as stated in the report of said master, requiring the dismissal of the original bill of the Cambria Steel Company in this cause, said intervenor is not entitled to relief under the intervening petition filed herein by the Kansas City Southern Railway

Company, and that said petitions as to each and all of the parts thereof should be dismissed.

So far from excepting "to the conclusion" of the master on the liability issue, so as to challenge the *correctness* of his conclusion, the Trust Company consistently at all stages of this proceeding (until the time for an appeal by its adversaries on the stoutly contested issue as to the existence of any claim against the Belt Company had been lost by lapse of time), insisted that the liability issue was *not* in the case, and could *not* be decided.

The reasons assigned by the Trust Company in its exceptions quoted above, "that no relief was asked by this defendant against said intervenor," and "that the personal liability of said intervenor is not at issue in this case," and "that said matter was for the determination of the Circuit Court of Jackson County, Missouri, in three cases then and now pending in said circuit court" are all inconsistent with the statement of the court that the Trust Company excepted "to this conclusion" of the master on the liability issue, so as to bring that issue before the lower court for determination, or before the court of appeals upon appeal.

Even in June, 1911, after the first argument of the case in the court of appeals, a year (lacking a few days) after the final decree, we find the Trust Company then insisting (Rec. 970), that "the question of the personal liability of the Kansas City Southern Railway Company for the debt of the Belt Company is not in issue and cannot be determined upon this appeal."

Surely when counsel, in formulating and filing their exceptions, were exerting themselves to *avoid* a decision of the liability issue, by insisting that the report of the master was erroneous because he "should have omitted reference to a recommendation concerning" that question, in all fairness it ought not to be said that "to this conclusion the Trust Company excepted," *so as to make the merits of the liability question one of the issues upon appeal.* The larger portion of the 34,000 pages of testimony, no part of which is included in the record here, was directed to establishing on the one side and defeating on the other, the claim that the Trust Company was a creditor of the Belt Company. When the master decided that the Southern was not liable for the debt of the Trust Company, the latter placed itself on the broad ground that the question of the liability of the Southern Company for the debt

was not involved in the action and urged the *inclusion* of that finding in the decree as a ground of error. The Southern was justified in regarding the latter question as out of the case and hence did not appeal from that part of the decision establishing the existence of the debt, which it would otherwise have done. The Southern Company now finds itself confronted with a finding by the appellate court that the question of its liability *was* in issue, although the Trust Company has throughout insisted to the contrary, and that the Southern Company is liable for the debt. *The Southern Company, therefore, is deprived of its contention that there was no debt for which it could be liable.*

4. The court in speaking of the power of the committee to discharge the floating debt of the old company, says at page 712:

> It (the plan) set apart $475,000 for the payment of floating debts; it expressly authorized the committee to acquire, hold or extinguish "any obligation in the nature of floating debt or otherwise against any company or property embraced in said plan," and under this power the committee actually expended $1,164,172.50. * * * The committee and the Southern Company therefore had ample power to realize and pay to the creditors of the Belt Company the value of their equity in the property of the Belt Company before they transferred that property to the Southern Company.

This, it is respectfully submitted, shows a total misconception of the floating debt provision of the plan, and is mainly accountable for what we claim to be the fundamental error of the court upon this branch of the case. There was much testimony upon the subject, as appears from the report of the master—pp. 859-861. The sole purpose of the appropriation of $475,000 for the payment of floating debt was, as stated by the master (Rec. 860),

> —to make provision for the payment and discharge of such obligations as the committee might find necessary to discharge, *in order to relieve the properties to be included in the Southern mortgage from any liens claimed thereon or from any interference as a matter of business policy.*

It is true that the *joint payments* of the committee and the Southern Company—not the payments on this account made by the committee alone as stated by the court—largely exceeded the estimate of $475,000, amounting in the aggregate to $1,164,172.50, (Rec. 860). But *all* of these payments, as will be more fully

shown hereafter, were made in order to remove *liens and claims of liens* upon the reorganized properties, so that the new mortgage should be a first charge. The master, in speaking of the payments in excess of the estimate, said (Rec. 860):

> In other words, the Trust Company, presumably, received its proportionate benefit from this large expenditure in payment of what are called the floating debts, but which *in reality consist of all kinds of items, which the committee deemed necessary to take care of so as to secure absolutely the first mortgage lien on the properties transferred to the Southern Company.*

It also appears from the findings of the master (Rec. 861),

> —that at no time did the committee in making such estimate (of $475,000), contemplate or include therein the indebtedness of the Belt Company to the Trust Company.

It is apparent, therefore, that the discretion of the committee, in the payment of floating debt, was limited, and did not include general authority to discharge all unsecured debts such as that of the Trust Company, without regard to their position as actual or potential charges against the properties.

5. The court, in giving its reasons for its conclusion that the Trust Company is not estopped to maintain this action, says, page 713:

> In December, 1899, or during the early part of the year 1900, the Trust Company requested a prominent member of the reorganization committee to adjust or settle and pay its claim against the Belt Company, and he answered that it was asserted that the Belt Company did not owe the Trust Company anything, that an examination of the books of the Belt Company and the books of the Trust Company was being made and *that when that was completed he would take up the question of whether anything could be done towards an equitable settlement of the claim.*

This obviously refers to the testimony of Max Pam, an abstract of which is contained in the master's report (Rec. 863). But the master's recital of his *entire testimony* could not have created the belief, in the mind of anyone, that the committee expected to pay the debt of the Trust Company. It is true that he stated that if an accounting were had it would appear that the Trust Company was indebted to the Belt Company, and that an examination

of the Belt Company's books and the Trust Company's books was being made, and that when this was done "he would take up the question of whether anything could be done towards an amicable adjustment of the claim." *But the matter did not stop there.* His suggestion, in reference to the examination of the books and the possibility of an amicable adjustment, was *rejected,* and both parties, thereupon, declared they would *stand upon their legal rights.* This is apparent from the report of the master who quotes Mr. Pam as saying further (Rec. 865), "that as the gentlemen present indicated a desire to *litigate the matter instead of waiting until the examination was completed,* he then stated that the Belt Company *would insist upon its legal defense,* and that *thereupon he withdrew from the meeting.*"

Furthermore, the master finds (Rec. 866), that there was no evidence of authority having been given to Max Pam, or to any other person, to make any "promise or representation which would be binding on the committee, even if such promise or representation had been attempted to be made, and for a sufficient consideration."

It is apparent, therefore, that taking the master's finding *as an entirety,* there was nothing in Mr. Pam's statement that could fairly lead anyone to believe *that any other course would be pursued than to leave the parties to the pursuit of such rights and remedies as the law afforded them.*

6. The court, again referring to the master's abstract of the testimony of Mr. Pam, says, page 716:

> What is the evidence of any laches of the Trust Company in these proceedings? It presented to one of the members of the committee its claim against the Belt Company for adjustment and settlement, and was told that when the examination of the books were completed, he would take up the matter whether anything could be done towards an equitable settlement of its claim and *there the matter rested until the Trust Company was enjoined from selling its collateral in September,* 1900.

We respectfully dissent from this statement. The master's recital of the testimony of the member of the reorganization committee referred to (which is all there is on that subject in the record), will be found at page 863. He said, as before stated, that an

examination of the books was being made, but that as the gentlemen present at the conference "indicated a desire to *litigate* the matter instead of waiting until the examination was complete," he "stated that the Belt Company would insist upon its *legal defense*" and "thereupon he withdrew from the meeting." Certainly no one could be "lulled into a feeling of security" by this statement.

Nor do we by any means concede that "there the matter rested" until September, 1900. If we are to believe the testimony of the president and general counsel of the Trust Company (Rec. 862), although the master found that he "was likely mistaken" (Rec. 863), Mr. Pam promised the Trust Company that its debt from the Belt Company would be paid on June 16, 1900. But it was *not* paid on that date, and *notwithstanding its non-payment* the Trust Company on July 26, 1900, surrendered its $1,294,841 par value of stocks and bonds of five of the old companies, and received in lieu thereof $1,480,909.20 par value of the stocks and bonds of the Southern Company.

7. The court, for a third time, refers to the evidence of Mr. Pam and, as we believe, misconceives its import. It says, page 718:

> The Trust Company presented its claim against the Belt Company to one of the committee and was told before it made its exchange that the indebtedness of the Belt Company was denied but was under investigation, and that when the investigation was completed he would take up the claim and see if anything could be done about its settlement, and there the matter rested until after the exchange of stock was made. Meanwhile the Southern Company had the books of the Belt Company evidencing the state of the account between the Belt Company and the Trust Company in its possession. The Trust Company never made any representation that it had no claim against the Belt Company nor that it would not press it for payment by the committee, by the Belt Company and by the Southern Company, but it gave notice of its claim and requested its payment and neither the committee nor the Southern Company ever declared before the Trust Company exchanged its stock and bonds that they would not settle or pay it if the Belt Company really owed it.

It is unnecessary to repeat what has already been said concerning Mr. Pam's testimony. On one hand there was a declared

intention to "litigate" and on the other an insistence on "legal defenses." No one could have been misled by this situation.

8. The court, in stating its conclusion, which we believe to be erroneous, that the issue of debt or no debt between the Belt Company and the Trust Company was made up in *December, 1900*, says, page 714:

> On September 6, 1900, the Cambria Company commenced the suit here in hand against the Belt Company and against the Trust Company to enjoin the latter company from selling its collaterals and applying their proceeds to the payment of the debt of the Belt Company, a suit which is founded on the averment, which has been adjudged untrue, that the Belt Company was not indebted to the Trust Company and on other allegations so baseless that it has become clear that the Cambria Company had no cause of action against the Trust Company. On September 6, 1900, the Belt Company, the hand of the Southern Company, appeared in the Cambria suit, and on the same day the Trust Company was restrained by the court from selling its collaterals, and receivers of the property of the Belt Company were appointed in this suit. On November 5, 1900, the Trust Company answered and set up its claim against the Belt Company and the pledging of its collaterals. On December 3, 1900, the Cambria Company filed a replication to that answer. On that day *the issue of the indebtedness of the Belt Company to the Trust Company was made in this suit*, and that issue really existed then between the Trust Company and the Southern Company, for the Southern Company by its ownership of ninety-seven per cent of the Belt Company's stock controlled it and in all subsequent proceedings directed its course and is as much bound by its action as though it had been the Belt Company itself.

It is true that on December 3, 1900, the issues were made between the Cambria Company on the one hand, and the defendants in the Cambria bill, on the other. But the issues between the Belt Company and its receivers on the one hand, and the Trust Company and others on the other, were not made until April, 1902, and then in the following manner:

The receivers of the Belt Company were authorized by the court in the order of their appointment (Rec. 29), to bring suits for accounting covering past dealings, which obviously referred to this proceeding, and accordingly an ancillary bill, or cross-bill,

was filed by the receivers *alone*, the date of which does not appear in the record. But on November 20, 1901 (Rec. 889), a stipulation, dated November 12, 1901, was filed which provided (Rec. 890, 891), that an accounting should be had, that the Belt Company should be a co-complainant with the receivers, and that at the end of the accounting the successful party should have judgment. The ancillary bill of the Belt Company and its receivers was filed on November 20, 1901, (Rec. 97). The Trust Company and its receiver filed their answer on December 9, 1901 (Rec. 115). Exceptions to the answer were sustained on April 1, 1902, (Rec. 161), and the replication of the Belt Company and its receiver was filed April 9, 1902 (Rec. 160), on which date the issues were made. The Southern Company did not come into the case until February, 1905 (Rec. 164).

It is apparent, therefore, that the issues made by the appearance of the Belt Company and its receivers in the case were not made until April, 1902.

9. The court, in what we believe to be a wholly unwarranted effort to charge the Southern Company with delaying this case, says, p. 714:

> This issue was referred to the special master and it was not until May 21, 1910, after testimony had been taken for years and after a record of approximately 34,000 pages had been accumulated, that the Trust Company succeeded in obtaining an adjudication thereof, and that issue was first determined by the court below a few days later. *It will be interesting to note a few of the proceedings which resulted in this delay.*

Then follows an enumeration of incidents which are alleged by the court to have delayed this proceeding from December 3, 1900, (this should be April 9, 1902), until May 21, 1910, to which it is deemed necessary to give consideration.

(a) It is stated by the court, p. 714, as one "of the proceedings which resulted in this delay:"

> Before the Trust Company reached a decision of the master more than fifteen pleadings were filed in this case by other parties to this suit, and *the Trust Company was compelled to file six.*

It is true that the Trust Company filed answers as follows:

(1) On November 5, 1900, to the bill of the Cambria Company, (Rec. 33);

(2) On December 9, 1901, to the ancillary bill of the Belt Company and its receivers, (the answer being filed out of time by *stipulation*, Rec. 114-115);

(3) On March 7, 1905, to the intervening petition of the Southern Company (Rec. 186), (the petition and answer being filed by *stipulation*, Rec. 164-166);

(4) On May 20, 1905, to the amended intervening petition of the Southern Company (Rec. 293), the amendment being made by *stipulation* (Rec. 267), and the *time for answering having been enlarged by agreement* (Rec. 292);

(5) On June 1, 1905, to the first amended ancillary bill (Rec. 312), filed by *agreement* (Rec. 266), to meet the Trust Company's demand for a more specific statement; and

(6) On July 2, 1906, to the second amended ancillary bill of Belt Company and its receivers (Rec. 461), the amended bill and the amended answer being filed at the same time by *stipulation* dated June 30, 1906, (Rec. 467), to conform the pleadings to the proof, all evidence having been taken and the case then being ready for argument before the master.

We submit in all fairness that the court was not justified in saying that the Trust Company was "compelled" to file six answers, and assign that as a cause of delay in this case, when as a matter of fact all of its answers in this many-sided and complicated litigation (except its answer to the Cambria bill), were filed *by agreement of parties to speed the cause to a final determination*, and there is nothing to indicate that the delays were not due to its action in filing these answers and to the proofs offered by it thereon.

(b) The court assigns the Provident foreclosure action as another cause for the delay of this case, as follows, page 714:

> On October 20, 1900, the Trust Company filed a petition in the Provident Company's foreclosure suit for leave to be made a party and to plead therein, wherein it set forth its claim against the Belt Company, that the Southern Company would cause the Belt Company to waive all defenses and to consent to a foreclosure of the mortgage upon its property to the detriment of the Trust Company and the creditors of the Belt Company. On October 22, 1900, the Provident Com-

pany amended its bill and asked that the Trust Company be made a defendant, and the court so ordered. On October 22, 1900, the Provident Company amended its bill and asked that the Trust Company be made a defendant, and the court so ordered. On November 5, 1900, the Trust Company answered the Provident Company's bill and in its answer set forth the debt of the Belt Company to it, the control of the Belt Company by the Southern Company and its purpose to waive all defenses to and to consent to the foreclosure of the Belt Company's mortgage and the sale of its property for the purpose and with the effect of appropriating the equity of its unsecured creditors to itself. On September 12, 1901, and again on October 14, 1901, the Trust Company applied for leave to file its amended and supplemental answer in which it set forth the debt of the Belt Company to it, the facts regarding the reorganization agreement, the organization of the Southern Company, its exchange of its stock for the stock of the Belt Company and its purpose, by the control of the Belt Company and of its bonds and stock, to appropriate to itself the equity of the creditors of the Belt Company in its property by means of the foreclosure suit, and prayed that the bill of the Provident Company be dismissed and for such further orders and decrees as it was entitled to receive. On October 19, 1901, the court ordered the application denied on condition that the Provident Company should file a stipulation to the effect that the decree of foreclosure to be rendered in its case should not bar the right of the Trust Company to plead and insist in any future litigation that the Southern Company was legally and equitably bound by reason of the method by which it would obtain the property of the Belt Company to pay the debt of the Belt Company to the Trust Company. On October 19, 1901, the Provident Company filed such a stipulation and the court denied the Trust Company leave to file its amended answer. On October 19, 1901, the Trust Company presented to the Court in the Provident Company suit a petition for leave to prepare and file a cross-bill setting forth the facts stated in its amended answer, and praying for an adjudication of its claim against the Belt Company for the sale of its collaterals and for a provision in the decree of foreclosure that any purchaser of the Belt Company's property at the sale thereunder should take and hold it subject to the payment of the Trust Company's claim and to the payment of the claims of all the unsecured creditors of the Belt Company. On October 19, 1901, the Belt Company filed its answer whereby it admitted the averments of the Provident Company in its bill. On No-

vember 6, 1901, the court entered the decree of foreclosure and sale of the Belt Company which contained the express condition stipulated by the Provident Company that the decree should not bar the right of the Trust Company to recover of the Southern Company personally or out of the property of the Belt Company the amount of its claim against that Company.

On December 31, 1901, the Southern Company bid in the Belt property at the Provident Company's foreclosure sale and the master conveyed it to the Southern Company.

The foregoing matters refer to the *foreclosure suit* of the Provident Company against the Belt Company. The various pleadings, orders and other papers referred to by the court *are not in this record*, which is the identical record that was before the court of appeals. It is true a stipulation was made on June 30, 1906, shortly before the argument before the master (Rec. 469), providing that any party to the cause should have the right upon the hearing of this case to refer to any part of the record in the Provident case, but no part of the record in that case was taken by the Trust Company to the court of appeals, so that we do not feel at liberty to comment upon its contents.

But the court's reference to the record in the Provident case is for the avowed purpose "to note a few of the proceedings which resulted in this delay," in the determination of this case. Inasmuch as all the proceedings in the Provident case, as appears from the excerpt of the court's opinion above quoted, occurred *prior to April, 1902*, when the issues in this case between the Belt Company and its receivers and the Trust Company were made, pursuant to stipulation as above stated, it is not perceived how the progress of *this* case could by any possibility have been delayed thereby.

(c) The court, after reciting the filing of the intervenor's petition and amended intervening petition, and the answer of the Trust Company on May 25, 1905, says, p. 716:

> Then followed objections and arguments and testimony until on May 21, 1910, the master finally filed his report and in a few days thereafter the court rendered its decree.

As the evidence was not brought to the court of appeals, and therefore is not brought to this court, it is not possible to ascertain the number of the objections, nor by whom made, nor the

extent of the arguments, nor by whom made, but the master's report throws some light on the amount of evidence taken and gives some of the causes of the delay to which the court refers. He says (Rec., 579):

> There have been numerous occurrences, all more or less *unavoidable*, during the progress of this hearing, which have operated to materially *delay* the conclusion and filing of the master's report. There was an entire change of counsel for complainants and *respondents* in January, 1905, when hardly *one-fourth* of the record had been made, and thereby properly necessitating additional time for the new counsel to familiarize themselves with the pleadings and complicated state of facts presented by the evidence in the cause, and then again in 1909, there was another change in counsel for *respondent*, the Guardian Trust Company, which occasioned additional briefs and suggestions. For the past three years, the master has given a large part of his time to the examination and consideration of this lengthy record in connection with the arguments and briefs of the learned counsel for complainants and defendants and the intervenor.
>
> It is estimated that the items involved, first and last, in this accounting, will aggregate 10,000 to 12,000 and hence it will be readily seen that it has been impossible, within the compass of this report, to do more than group together the different classes of items which characterize the issues in this cause.

The taking of proofs was closed prior to June 30, 1906, (Rec. 468), and the case was argued for two weeks before the master in July, 1906, (Rec., 955-1023), and supplemental briefs filed on both sides afterwards in 1907 (Rec., 955-956), upon the liability issue made by the intervening petition of the Southern Company.

In the face of this recital by the master, and with no facts in the record to controvert it, was the court justified in placing the Southern in the attitude of having delayed the decision?

10. The court again makes what we believe to be an unwarranted charge of delay, saying, page 717:

> November 20, 1901, it joined the Belt Company and its receivers in a stipulation to expedite the trial of that issue and the entry of such a judgment, but *new pleadings*, tens of thousands of pages of testimony delayed the result. When that result seemed nearer and on February 27, 1905, the Southern Company intervened and claimed some of the Trust

Company's collaterals, and on March 7, 1905, the Trust Company answered the intervening petition and again pleaded and pressed its claim against the Southern Company. On March 17, 1905, and again on March 28, 1905, apparently despairing of reaching an adjudication in this suit in equity, it brought actions at law against the Southern Company upon its claim, but was prevented from trying them by injunctions procured and other proceedings conducted by the Southern Company until April 2, 1909, when the last injunction against its proceeding in the state court was reversed by this court.

The "new pleadings," everyone of them, as above shown, were filed *by consent*, by stipulation. The "tens of thousands of pages of testimony" are to be laid at the door of the Trust Company as well as its adversaries. There is nothing to justify charging the delay to either party rather than to the other. It is pure assumption. No one can claim that the intervention of the Southern Company delayed a final decision of the case, since only approximately *one-fourth* of the testimony had been taken at that time (Rec., 579).. The Trust Company in March, 1905, so far from "despairing of reaching an adjudication in this suit in equity" was bringing the same suit in the state court, *for an entirely different reason*. This case was argued and submitted to the master in July, 1906, which was much earlier than it could hope to secure a submission in the state court. It is to be hoped that its purpose in bringing the suits in the state court was not to duplicate the enormous expense of the litigation. Its obvious and avowed purpose was to *escape* an adjudication of the liability issue in the federal courts, as is indicated by its subsequent conduct in endeavoring to eliminate that issue from this case and to remit the decision of that question to the state courts.

11. The court says, page 717:

Twice in October, 1901, it set forth in answers to the Provident Company's suit its claim against the property of the Belt Company and against the Southern Company, and prayed the adjudication and payment thereof, to be met by a denial by the court doubtless secured by the objections of the Provident Company and by that Company's stipulation that the decree should not foreclose, bar or effect the Trust Company's claim against the Southern Company, or the property of the Belt Company which it should acquire thereunder. On October 19, 1901, it applied for leave to plead this claim on

a cross-bill in that suit and to pray for a decree that its claim should be paid out of the property of the Belt Company, to be met by like denial. In this way, the Trust Company was prevented from obtaining a hearing on the merits and an adjudication of its claim in the foreclosure suit and subjected to the objection to an original bill which it might otherwise have brought against the Southern Company that it had no judgment against the Belt Company and no execution returned unsatisfied thereon.

Again the court has recourse to the pleadings and proceedings in the Provident case which, unfortunately, are not in this record. It is not perceived, however, why the Trust Company did not have the same opportunity to file suit in the state court or elsewhere in 1901, that it had in 1905, when it finally brought the suits in the state court at Kansas City.

12. The court says, page 717:

> Meanwhile the Trust Company had pressed the issues in this suit through the hearings, they had been submitted to the master, and on May 21, 1910, he found that the Belt Company was indebted to the Trust Company in 1900, and that the amount of that debt with interest to June 22, 1910, was $639,658.86.

The inference created by this statement is that the Trust Company was pressing this action to a hearing, in the face of obstacles interposed by its adversaries. Nothing could be more unjust. It is not permitted to speak outside of the record, but we may refer to one significant fact in that connection which is of record (Rec., p. 1024), that after the master had taken over 34,000 pages of testimony, the Trust Company refused to prepare and file with him an abstract or abridgment of the testimony to aid him in reaching his conclusions. The Trust Company left the master to grope unaided through the maze of testimony and reach his conclusions as best he could. The Belt Company and its receivers on the contrary did prepare and file an abstract of the evidence covering each allegation of the bill and intervening petition (Rec. 1023).

13. The court in speaking of the efforts made by the parties in the lower court to secure an adjudication of the issues herein involved, one side insisting that the litigation be carried on in the

state court and the other insisting upon the federal court, says at page 699:

> This question (the liability of the Southern Company) has been at issue between the Trust Company and the Southern Company in this suit and in action at law in the state courts for many years. The prosecution of those actions had been *repeatedly* enjoined and delayed by orders of the court below and those orders had been *as often reversed* by this court.

The prosecution of the suits in the state court was twice temporarily enjoined by the lower court, and in each instance the order of injunction was reversed by the court of appeals (146 Fed. 337; 171 Fed. 43). Each of the parties, as frequently happens, was contending for an adjudication in the forum of its preference, and no unfavorable inference can justly be drawn therefrom. We are unable to see why an effort to prevent a duplication of the enormous expense and labor involved in this case by confining the litigation to one court was not commendable from every standpoint. The good faith of the Southern Company, in seeking to confine this litigation to the federal courts, where it originated, as ancillary to the foreclosure proceeding in which the property of the Belt Company was sold, will not suffer, it is respectfully submitted, by inquiring whether the principles and rules recently announced in March, 1915, by the same court of appeals, in *Western Union Telegraph* v. *Trust Company*, 221 Fed., 545, did not justify the application for the injunctive order which was reversed in the case reported in 146 Fed., 337.

SPECIFICATION OF ERRORS.

For specifications of error (Rec., 1058), the appellant says that the circuit court of appeals for the eighth circuit erred in this, to-wit:

1. In holding and deciding that The Kansas City Southern Railway Company was liable for and required to pay to the Guardian Trust Company the indebtedness of the Kansas City Suburban Belt Railroad Company to the Guardian Trust Company.

2. In holding and deciding that the rights and equities of the Guardian Trust Company in the properties and capital stock of the Central Improvement Company were prior and superior to the rights and equities therein of the Kansas City Southern Railway Company.

3. In holding and deciding that the Guardian Trust Company was not estopped by its participation in, and the benefits received and retained by it from, and growing out of the plan of reorganization involved herein, from maintaining that the Kansas City Southern Railway Company was or is liable for the indebtedness of the Kansas City Suburban Belt Railroad Company to the Guardian Trust Company.

4. In deciding and passing upon the issue of the alleged liability of the appellant for the indebtedness of the Belt Company, in the absence of any exception taken before the master, or in the lower court, challenging the correctness of the finding of the master that the appellant was not liable for such indebtedness.

BRIEF.

I.

The decision of the circuit court of appeals was not final and this Court has jurisdiction over this cause upon this appeal and the motion to dismiss should be denied.

It is important to bear in mind that the questions presented by this appeal for the consideration and determination of this court are *essentially federal questions* arising under the laws of the United States. They involve the validity and effect, in a collateral proceeding, of a decree of foreclosure and sale of railway property, duly entered and made effective by a circuit court of the United States.

Our contention is that the decision of the court of appeals was not final, and that this court has jurisdiction over this cause upon this appeal for each of the following reasons:

First. The original bill of the Cambria Company in this case presented a distinct ground of federal jurisdiction independent of that of diversity of citizenship.

Second. The intervening petition of the Southern Company, which was in the nature of an original bill, stated facts sufficient to confer jurisdiction upon a federal court, independent of the grounds of jurisdiction stated in the original bill.

1. *The original bill of the Cambria Company not only demanded an accounting, but also sought to establish and enforce a judgment lien, created by Act of Congress, and therefore, the jurisdiction of the circuit court was not entirely dependent upon diversity of citizenship.* If the bill of the Cambria Company stated facts sufficient to present a distinct ground of federal jurisdiction independent of that of diversity of citizenship, then the decision of the court of appeals was not final and the motion to dismiss the appeal must be overruled. (*Mayor of Vicksburg* v. *Henson*, 34 Sup. Ct. Rep. 95; *Warner* v. *Searle*, 191 U. S. 195; *St. Louis Railway Company* v. *Wabash Company*, 217 U. S. 247; *Howard* v. *United States*, 184 U. S. 676; *Union Pacific Ry. Co.* v. *Harris*, 158 U. S. 326; *Mississippi Commission* v. *Railway Company*, 203 U. S. 335; *United States Fidelity Company* v.

Bray, 225 U. S. 205). Even though the averments are "quite defective" the appeal will not be dismissed (*Warner* v. *Searle*, *supra*).

It is the *face of the bill* of the Cambria Company to which we must look for the jurisdictional averments. It is not material or important what questions arising upon the issues made by this bill were actually decided. (*Florida Central* v. *Bell*, 176 U. S. 321; *Omaha Electric Co.* v. *Omaha*, 230 U. S. 123; *Siler* v. *Louisville Railway Company*, 213 U. S. 175).

It becomes necessary, therefore, to examine the bill of the Cambria Company (Rec., 3-20), bearing in mind the Act of Congress of August 1, 1888, entitled "An act to regulate the liens of judgments and decrees of the courts of the United States" (25 Stat. L. 357) which provides that:

> Judgments and decrees rendered in a circuit or district court of the United States within any state shall be liens on the property throughout such state, in the same manner, and to the same extent, and under the same conditions, only as if such judgments and decrees had been rendered by a court of general jurisdiction of such state; provided, that whenever the laws of any state require a judgment or decree of a state court to be registered, recorded, docketed, indexed, or any other thing to be done, in a particular manner, or in a certain office or county, or parish in the State of Louisiana, before a lien shall attach, this act shall be applicable therein whenever and only whenever the laws of such State shall authorize the judgments and decrees of the United States courts to be registered, recorded, docketed, indexed, or otherwise conformed to the rules and requirements relating to the judgments and decrees of the courts of the State.

And also the following statutes of the State of Missouri (1909):

> Section 3123. Judgments and decrees obtained in the Supreme Court, in any United States District or Circuit Court, held within this state, in the Kansas City Court of Appeals or the St. Louis Court of Appeals, shall upon the filing of a transcript thereof in the office of the clerk of any such court, be a lien on the real estate of the person against whom such judgment or decree is rendered situate in the county in which such transcript is filed.
>
> Section 3124. Judgments and decrees rendered by any court of record shall be a lien on the real estate of the

person against whom they are rendered situate in the county for which the court is held.

The bill of the Cambria Company may be summarized as follows:

(a) After the formal averment of the incorporation and citizenship of the parties it is alleged (Rec., 5), that the Cambria Company on September 6, 1900, obtained judgment in an action at law in the circuit court of the United States for the Western Division of the Western District of Missouri, against the Belt Company in the sum of $100,962.91; that execution was issued and returned wholly unsatisfied; and that the Belt Company had no property subject to be reached by legal process issued upon the judgment.

(b) It is next charged (Rec., 5), that the Trust Company organized a large number of railroad companies to construct railroads, and a large number of auxiliary companies, the latter for the purpose of holding the legal title to lands, buildings and other structures necessary to be used by the railroad companies in their operations; that the Trust Company controlled these companies by the election of its own officers and employes as their officers and employes, and used them for its own benefit, and that thereby it assumed a fiduciary relation toward them; that among the companies so organized (Rec., 6-9), were the following railroad companies, Kansas City Suburban Belt Railroad Company and its subsidiary companies, the Union Terminal Railroad Company, Kansas City, Independence Air Line; and the following auxiliary companies (Rec., 13), Missouri Elevator & Terminal Company, Central Improvement Company, Second Street Improvement Company, Fairmount Amusement Company, and Northern Townsite Company.

(c) With reference to the railway companies it is charged that the Trust Company appropriated all of their stocks and bonds and applied a portion of the proceeds thereof to the cost of construction of their properties, and refused to account for the remainder, and an accounting was demanded.

(d) With reference to the auxiliary companies it was charged that the Trust Company fraudulently invested them with

the legal title to various properties, both personal and real, which in equity belonged to the Belt Company, and the Cambria Company sought by its bill to impress its *judgment lien* upon them. It is alleged (Rec., 10), that tthe Trust Company acted:

> With the fraudulent intent and purpose of preventing the properties so taken in the names of said auxiliary companies, respectively, from being reached by the creditors of said railroad companies or either of them and particularly by the creditors of the said Belt Company; * * * that, as your orator is informed and believes, all or substantially all of the moneys invested in the purchase, improvement and acquisition of the several properties of the said auxiliary companies and each of them, was paid and supplied by the said Belt Company, and each and every one of the said auxiliary companies was a mere device or "dummy" contrived and provided by the said Trust Company as a means for taking and holding the naked *legal title* to such properties as might be vested in the said auxiliary companies, respectively, for the use and benefit of the said Belt Company, and that, as to the creditors of the said Belt Company and particularly as to your orator, *the properties and shares of stock of each and every of the said auxiliary companies in equity belong to the said Belt Company and are chargeable with the lien and payment of your orator's aforesaid judgment against the said Belt Company;* a list of real estate in the name of the auxiliary companies so far as known to complainant, is attached hereto as Exhibit 2. (Exhibit 2, Rec., 23-27, being a list of real estate situated in Kansas City, Missouri).

(e) It is next averred (Rec., 14-15), that the Trust Company fraudulently, by reason of its control and domination, caused the Belt Company to transfer and deliver to it certain promissory notes and a large amount of property of various kinds, consisting of bonds, shares of stock, steel rails and other property, all of which it is charged rightfully and in equity belonged to the Belt Company, and should be subjected to the *judgment lien* of the complainant. It is alleged (Rec., 15):

> Your orator charges that each and all of the aforesaid shares of stock, assets and other personal property so passing into the possession of the said Trust Company, constitute assets and property of the said Belt Company, *equitably and justly chargeable with the lien and payment of your orator's aforesaid judgment,* and that the said shares of stock and other property were fraudulently taken into the possession

of said Trust Company without consideration moving from the said Trust Company, and that said Trust Company has no right to such possession or title to any part of said stocks, or property.

(f) It is further charged that the Elevator Company, owning several elevators in Kansas City, Missouri, was a mere device or dummy to hold the legal title to its property for and on behalf of the Belt Company; that the Central Company (Rec., 16), was likewise a mere dummy contrived by the Trust Company to hold and carry the legal title to the real property standing in its name for the use and benefit of the Belt Company and its creditors; that the same was true of the Second Street Company, which among other things, held the legal title to certain tracts of real estate in and near Kansas City, Missouri, and used and indispensably necessary to be used by the Belt Company for depot grounds, necessary buildings, rights of way, yards, freight houses and machine shops; and,

That the said property in equity belongs to the said Belt Company and is chargeable with the debts and liabilities thereof, including the *judgment* of your orator as aforesaid.

It is also charged that the property and assets, the legal title to which is held by the Amusement Company and the Townsite Company, respectively, are essential and indispensable to the successful operation of the property of the Belt Company, and that the Amusement Company and Townsite Company are dummies of the Trust Company for the purpose of holding the legal title to said assets and property for the use and benefit of the Belt Company, as the equitable owner thereof, and,

That such assets and property so held are equitably and justly chargeable with the claims and demands of the creditors of the said Belt Company, and particularly the *judgment* so obtained by your orator as aforesaid.

(g) Then follows a prayer for the *establishment of the lien of complainant's judgment* against the Belt Company's equitable title to the various properties held for it by these dummy corporations as follows (Rec., 18):

That the property and assets, the legal title to which is held, respectively, by the said Elevator Company, Amusement Company, Central Company, Second Street Company, and

> Townsite Company be declared to be in equity the property of the said Belt Company, and chargeable with the *lien* and payment of the debts and liabilities of the said Belt Company, and, particularly, the judgment aforesaid of your orator.

Next follows a prayer for the sale and distribution of the assets and property of the Belt Company in the order of the respective liens of its creditors as follows:

> (d) That the assets and property of the said Belt Company, real, personal, or mixed, and wheresoever situated, including all rights of action, legal or equitable, be marshalled for the benefit and protection of all persons concerned therein.
>
> (e) That the rights and interests of all persons in and to the said assets of the said Belt Company, be ascertained, adjudicated and decreed.
>
> (f) That the said assets and property, and each and every part thereof, be sold and the proceeds thereof, after paying the costs and expenses of this proceeding and all allowances which may be made therein, be distributed among those found to be entitled thereto.

(h) It is beyond question that the bill asserted a *judgment lien,* created by an act of Congress, upon the equitable title of the judgment debtor to various properties both real and personal, which were held or claimed adversely by the Trust Company, and sought to impress and establish such judgment lien upon these properties and to foreclose the lien and sell the properties and to distribute the proceeds to the parties equitably entitled thereto.

It is equally beyond question that the Trust Company *understood* that this was one of the issues tendered by the bill, for it says in its answer (Rec., 49) that it,

> Denies that all or any of the said companies were mere devices or dummies contrived and provided by this defendant as a means for taking title to such property as might be vested in them for the use and benefit of the Belt Company, and denies that the properties and shares of stock of the so-called auxiliary companies in equity belong to the Belt Company *and are therefore chargeable with the lien of the complainant's said judgment as alleged in the bill of complainant.*

(i) The Cambria Company on January 22, 1914, (Rec., 1055) applied to the court of appeals for leave to amend its bill, making a specific reference to the Act of Congress of August 1,

1888, and to the Missouri Statutes, above quoted, in reference to judgment liens, and stating in express language that the suit arose under the laws of the United States, invoking the rule of *Vicksburg* v. *Henson*, 231 U. S., 259, 34 Sup. Ct. Rep., 95, which permits additional grounds of jurisdiction, existing at the time of the filing of the original bill, to be added by amendment. The court of appeals denied leave to make the amendment (Rec., 1056). The allegations of the proposed amendment are in respect of matters of which the court will take judicial notice, so that the action of the court of appeals in denying the motion is not important.

2. *Where, as in this case, the bill asserts a judgment lien created by Act of Congress and seeks to establish and enforce the lien against the equitable title to certain properties of the judgment debtor, the action arises under the laws and constitution of the United States and presents a distinct ground of federal jurisdiction independent of that of diversity of citizenship.* The lien of the judgment rendered in the federal court was a creature of the federal statute. The validity and effect of the lien as well as of the statute itself were involved in the case. The decree establishing or denying the lien claimed by the complainant would naturally turn upon the validity, construction, and effect of the statute.

Where the case made by the plaintiff is one which depends upon the proper construction of an act of Congress with the contingency of being sustained by one construction and defeated by another, it is one arising under the laws of the United States. (*Northern Pacific Railway Co.* v. *Soderberg*, 188 U. S., 526; *Ex Parte Lennon*, 156 U. S., 548).

As an illustration of the application of this rule to this case it is pertinent to inquire:

(a) Did the lien created by the Act of August 1, 1888, extend to the *equitable title* of the judgment debtor to the real properties described in the bill? (The judgment lien created by the Missouri Statutes above quoted, which statutes may or may not be a part of the federal act, extends to equitable as well as legal interests. *Williams* v. *Lobban*, 206 Mo., 399, 410; *Eneberg* v. *Carter*, 98 Mo., 647, 650; *Slatterly* v. *Jones*, 96 Mo., 216).

(b) Did the act of Congress adopt this Missouri Statute and with it its construction by the Missouri courts?

(c) Did the Act of Congress creating a judgment lien *supersede* the Missouri statute which also undertakes to create a judgment lien in favor of judgments rendered in federal courts?

Upon the determination of these questions the existence and validity of the lien of the complainant may depend.

These questions appear *on the face* of the bill of the Cambria Company, and at once *involve and require a construction of the act of Congress*, with the necessary result that by one construction of the act the right of the complainant will be sustained, and by another construction such right will be defeated.

But it has been expressly determined by this court (*Cooke* v. *Avery*, 147 U. S., 375) *that an action which seeks to establish and enforce a judgment lien created by an act of Congress is an action arising under the laws of the United States.* There the contest was over certain real property and the plaintiff alleged that he derived his title from the sale of the property under the *lien of the judgment* rendered by the Circuit Court of the United States for the Northern District of Texas, and the action was sustained as one arising under the laws and constitution of the United States, without regard to the citizenship of the parties, for the reason that the validity of the plaintiff's title depended upon the *existence of the lien* and the determination of that question involved the *construction and application of the act of Congress which created the lien.*

The act of Congress relied upon was the Act of June 1, 1872, (Sec. 916, Revised Statutes) which provided that the parties recovering a judgment in any common law action should be entitled to similar remedies by execution or otherwise, to reach the property of the judgment debtor as were then provided in like causes by the laws of the state in which such court was held. This was the statute which preceded the Act of August 1, 1888, which expressly gave a lien to the judgments of the courts of the United States.

This court said, in upholding the jurisdiction of the court:

> Plaintiff is to be regarded as the purchaser at the sale, and the *validity* of his purchase turned upon the *existence of a lien*, which he asserted and the defendants denied. The *disposition of this issue* depended upon the laws of the United States and the rules of the circuit court, and *their construction and application were directly involved.* We are of opinion

that jurisdiction as resting on the subject-matter was properly invoked.

Does not this case conclusively establish our right to an appeal? The right of the Cambria Company to relief turned upon the *existence of the judgment lien* created by act of Congress, which the Cambria Company asserted and the Trust Company denied. Did not the disposition of this issue depend upon the laws of the United States, and was not the jurisdiction of the lower court as depending upon the subject-matter properly invoked?

The same conclusion was reached by the circuit court of appeals of the fourth circuit in *First National Bank* v. *Society for Savings*, 80 Fed., 581. There a federal circuit court issued a mandamus requiring the county court to levy a tax to pay a judgment against the county. Certain inhabitants of the town filed a bill in the state court to enjoin the levy on property in the town, claiming that such property was not subject to the claim upon which the judgment was based. This injunction suit was then removed by defendants to the federal court. It was held that the latter court had jurisdiction of the injunction suit, *as it involved the enforcement of a judgment of a federal court acting under the federal laws and constitution.* The court said:

> This proceeding is in the nature of an execution. The rights of the parties to the judgment in respect of its subject-matter are fixed by its rendition. *City of Chanute* v. *Trader*, 132 U. S., 210. This being so, the proceeding in the state court involves the enforcement of a judgment of the United States circuit court, acting under the constitution and laws of the United States, and it is, therefore, *a question arising under that constitution and those laws*, and so within the jurisdiction of the federal court.

The case of *Soades* v. *Witters*, 46 Fed., 497, is also directly in point. It is there held:

> The laws of a state respecting the enforcement of judgments, adopted, pursuant to Rev. St. U. S. 916, by a rule of the federal district court for the government of judgment liens of such court, and for the guidance of the marshal in levying executions, derive their force from the United States, and not from the state; and a suit involving *the question whether or not the marshal's proceedings in levying an execution issued out of the federal court was in conformity with such rule is a question arising under the laws of the United States, and cognizable by the federal courts.*

The reason of the rule finds support in many adjudicated cases. An action on the bond of a marshal of the United States, or on the bond of a clerk, or on the official bond of a cashier of a national bank, or on the bond of a federal contractor given for the protection of persons furnishing materials and labor for the construction of public works, or on a supersedeas bond, are held to arise under the laws of the United States for the reason that the case depends upon the scope and effect of the bond and the meaning of the statute under which it was given. (*Bock* v. *Perkins*, 139 U. S., 628; *Howard* v. *United States*, 184 U. S., 676; *Walker* v. *Bank*, 56 Fed., 76; *Hill* v. *Surety Company*, 200 U. S., 197; *United States* v. *Bonding Co.*, 89 Fed., 925; *United States* v. *National Surety Co.*, 92 Fed., 549; *United States* v. *Rundle*, 100 Fed., 400; *Hardaway* v. *Surety Company*, 150 Fed., 465; *Seymour* v. *Phillips*, 7 Biss., 460).

An action against a corporation created by Congress is one arising under the laws of the United States for the reason that the corporation has no powers and can incur no obligations except as authorized or provided by its charter. (*Removal Cases*, 150 U. S., 1; *Railway Co.* v. *Cox*, 145 U. S., 593). Likewise, an action on an injunction bond given in the course of proceedings in the federal court arises under the laws of the United States for the reason that it is to be construed with reference to the liability administered in the courts of the United States on that subject. (*Tullock* v. *Mulvane*, 184 U. S., 497; *Railway Company* v. *Elliott*, 184 U. S., 530).

In the recent case of *American Surety Company* v. *Schultz*, 35 Sup. Ct. Rep., 525, it was held that a suit on a supersedeas bond, given in conformity to the Federal statute to supersede a judgment in an action for a breach of contract during the pendency of a writ of error from a Federal circuit court of appeals, is one which "arises under the constitution or laws of the United States," and that the district courts of the United States had jurisdiction of an action on such a supersedeas bond, irrespective of the citizenship of the parties. The court, after noting that the bond was given in pursuance of the laws of the United States, said:

> Conversely, when that judgment was affirmed, the same laws of the United States gave Schultz a right of action on the bond, and in the suit to enforce that right *the measure of*

his recovery depended upon the construction to be given the Federal statute. Such a suit to enforce such a right could be brought in the United States court by virtue of sec. 24 of the Judicial Code (36 Stat. at L. 1091, chap. 231, Comp. Stat. 1913, sec. 991), which declares that the district court has jurisdiction of any suit of a civil nature at common law which "arises under the constitution or laws of the United States."

That diversity of citizenship also existed in this case is not important. The controlling feature is that the complainant asserted the equitable title to certain real estate, and this equitable title depended for its *existence and validity* upon a judgment lien created by an act of Congress, and the validity and application of the judgment lien in turn depended upon the *construction of the act of Congress* creating it. These facts constituted a suit arising under the laws of the United States and gave to the circuit court an independent ground of jurisdiction in addition to that of diversity of citizenship.

3. *The intervening petition of the Southern Company was a suit arising under the laws of the United States and for that reason alone the right of appeal to this court exists, regardless of the source of jurisdiction of the Cambria bill.* The decision of the court of appeals in this case was not final for the further reason that the intervening petition of the Southern Company (which was in the nature of an original bill) asserted the equitable title to certain real and personal properties held or claimed by the Trust Company, based upon foreclosure decrees rendered in the United States circuit court for the Western district of Missouri and sales had thereunder at which the Southern Company became the purchaser. It was, therefore, a *"case arising under the laws of the United States establishing the circuit court and vesting it with jurisdiction;* and hence, it would be *within the judicial power* of the United States as defined by the constitution." (*Dupasseur* v. *Rochereau*, 21 Wall., 130; *Pittsburg Railroad Co.* v. *Long Island Trust Company*, 172 U. S., 493, 508; *Tullock* v. *Mulvane*, 184 U. S., 497).

There was involved the Constitution of the United States (Article III, Section 1) providing that the judicial power of the United States should be vested in the Supreme Court "and in such inferior courts as Congress may from time to time ordain and

establish," as well as the numerous acts of Congress defining the jurisdiction of the circuit courts of the United States and prescribing their procedure; and particularly the Act of March 3, 1893, entitled, "An Act to regulate the manner in which property shall be sold under orders and decrees of any United States courts" (27 Stat. L., 751).

The equitable title asserted by the Southern Company, as appears from the face of its petition, depended upon the *validity* of the foreclosure proceedings and the sales thereunder, and there was involved, therefore, the laws of the United States establishing the court, defining and limiting its jurisdiction of the subject-matter as well as of the parties, regulating the procedure in the course of the litigation, and prescribing with particularity the manner in which property shall be advertised and sold under the decrees of the court. The title asserted by the Southern Company would be defeated by a construction of the laws of the United States that would deny the jurisdiction of the courts passing the decrees, either over the subject-matter or of the parties, or that would invalidate the sale by reason of a failure to conduct it in accordance with the federal statute.

It was a necessary part of the case of the Southern Company that *under a proper construction of the acts of Congress* the courts passing the foreclosure decrees and conducting the sales had jurisdiction of the subject-matter and of the parties, the prescribed procedure had been followed and the sale had been made in the manner and at the place designated.

In other words, the Southern Company set up a right to recover as the result of a judicial sale made under a decree of the United States circuit court and, therefore, a federal question was presented.

This court, speaking through the present Chief Justice (*Commercial Publishing Co.* v. *Beckwith*, 188 U. S., 567), said:

> As in the complaint the plaintiff in error unquestionably set up a right to recover as the result of a judicial sale made under decrees, both of courts of the United States and of a state, Federal questions exist in the record, and the motion which has been made to dismiss is therefore denied.

In *State* v. *Frost*, 89 N. W., 915, foreclosure proceedings brought in a federal court against a railway company had ripened

into a decree. The master was unable to make a sale of the property at the up-set price named in the decree and reported that fact back to the court and asked for instructions. The court directed the receiver to take up the rails and ties for the purpose of selling them separately. The State of Wisconsin thereupon brought an original proceeding in the Supreme Court of Wisconsin to enjoin the receiver from taking up the rails and dismantling the road. Application was then made by the defendant to remove the case to the federal court upon the ground that the action arose under the laws and constitution of the United States. The right of removal was sustained, the court saying:

> It cannot be doubted that *the jurisdiction of the federal court depends wholly upon the constitution and laws of the United States;* nor that its power, after the expiration of a term, to modify a decree already entered, depends wholly upon the construction to be given to the *laws of Congress originating that court, and granting and defining its powers.*

Cooke v. *Avery*, 147 U. S., 375, and other cases cited under the preceding heading are also referred to as authority for this position.

Where an ancilliary bill upon its face presents federal questions, the right of appeal to this court from the circuit court of appeals exists, regardless of the source of jurisdiction of the main action. This has been expressly decided by this court in the recent case of *Railroad Commission of Ohio* v. *Worthington*, 225 U. S., 101. There, Worthington, who had been appointed receiver in an action depending solely upon diversity of citizenship, brought an ancillary bill to enjoin the enforcement of an order of the Railroad Commission of Ohio, invoking the Constitution of the United States, so that federal questions were provided on the face of the bill. The question arose as to whether a determination by the circuit court of appeals of the issues made by the ancillary bill was final, and this court held that it was not, and that the appeal had been properly allowed, saying:

> The argument that the jurisdiction of the circuit court of appeals is final is based upon the contention that, as Worthington, the complainant in the present case, was appointed receiver of the Wheeling & Lake Erie Railroad Company in a suit in equity in the circuit court of the United States for the northern district of Ohio, eastern division, wherein

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jurisdiction depended upon diversity of citizenship, and since the jurisdiction to entertain an appeal in an ancillary proceeding is that of the original case, therefore, under the circuit court of appeals act, the decree of the court of appeals is final. It is undoubtedly true that in cases of intervention in *foreclosure suits*, where jurisdiction depends upon diverse citizenship, jurisdiction of the intervening petition is determined by that of the original case. It is equally true that petitions in original proceedings to enforce rights and to protect the exercise of the jurisdiction of the court take their jurisdiction from that of the original case (*St. Louis, K. C. & C. R. Co.* v. *Wabash R. Co.*, 217 U. S., 247, 54 L. Ed. 752, 30 Sup. Ct. Rep. 510), and the many previous cases in this court therein cited.

An examination of the bill in this case, which was filed under the authority of the circuit court, shows that the order of the commission was attacked, not only upon the ground that its findings were alleged to be unsupported by the testimony and to have been made upon improper consideration of the facts, but also because the order affected and interfered with interstate commerce, in which the complainant was engaged and over which the Railroad Commission of Ohio had no authority, because of the commerce clause of the Federal constitution. It further was alleged that the owners of the property constituting the receivership estate would be deprived thereof without due process of law; that they would be denied the equal protection of the laws, and that their property would be taken without compensation. *It thus appears that jurisdiction was invoked, not only because the present case is ancillary to the receivership suit, which depended upon diverse citizenship, but upon grounds which involve alleged infractions of the Federal Constitution and rights secured thereby.* The case was therefore one which might have been taken to the circuit court of appeals, and the fact that it involved grounds which might have warranted a direct appeal to this court did not deprive the circuit court of appeals of jurisdiction. *American Sugar Ref. Co.* v. *New Orleans*, 181 U. S., 277, 45 L. Ed. 859, 21 Sup. Ct. Rep. 646; *Macfadden* v. *United States*, 213 U. S., 288, 53 L. Ed. 801, 29 Sup. Ct. Rep. 490.

The question, then, is: Is this one of the cases made final in the circuit court of appeals by the act creating that court? The 6th section of that act provides that the judgment of the circuit court of appeals, "shall be final in all cases in which the jurisdiction is dependent entirely upon the opposite parties to the suit or controversy being aliens and citizens of

the United States or citizens of different states; also in all cases arising under the patent laws, under the revenue laws, and under the criminal laws, and in admiralty cases." (26 Stat. at L. 828, chap. 517, U. S. Comp. Stat. 1901, p. 550). In all other cases there is a right of review by this court if the matter in controversy exceeds $1,000. It is averred in the bill and admitted in the answer that the amount in dispute exceeds in value the sum of $5,000. *The case is therefore one not made final in the circuit court of appeals, and the appeal to this court was properly allowed. Spreckels Sugar Ref. Co.* v. *McClain*, 192 U. S., 397, 48 L. ed. 496, 24 Sup. Ct. Rep. 376; *McFadden* v. *United States*, 213 U. S., 288, 294, 53 L. ed. 801, 802, 29 Sup. Ct. Rep. 490; *Standard Paint Co.* v. *Trinidad Asphalt Mfg. Co.*, 220 U. S., 446, 460, 55 L. ed. 536, 543, 31 Sup. Ct. Rep. 456.

We understand the present state of the law on this subject to be as follows:

(a) Where it is sought to appeal from a decision of the court of appeals rendered upon the issues made by an intervening petition or an ancillary or dependent bill which does not itself disclose upon its face grounds of federal jurisdiction, the right of appeal is to be referred to the original bill which first invoked the jurisdiction of the lower court. If the sole ground of jurisdiction disclosed on the face of the original bill was diversity of citizenship, then no appeal lies; but if the bill disclosed a cause of action arising under the laws of the United States, whether stated separately or in connection with a ground of jurisdiction founded upon diversity of citizenship, the right of appeal from the court of appeals to this court exists.

(b) Where it is sought to appeal from a decision of the court of appeals rendered upon the issues made by an intervening petition or an ancillary or dependent bill which discloses on its face grounds of federal jurisdiction, then the right of appeal exists, regardless of the source of jurisdiction disclosed on the face of the original bill as filed in the lower court.

It is the contention of the appellant in the case that it has a right of appeal to this court: *first*, for the reason that the bill of the Cambria Company disclosed a cause of action of which the circuit court would have had jurisdiction independent of diversity of citizenship; and, *secondly*, that the intervening petition of the

Southern Company sets forth a cause of action arising under the laws of the United States, and for that reason the right of an appeal exists wholly independent of the grounds of jurisdiction contained in the bill of the Cambria Company.

II.

The writ of certiorari should issue, (if the Court holds that the right of appeal does not exist) for the reason that grave and serious questions of great public interest are involved and for the further reason that the decision of the circuit court of appeals for the eighth circuit is in certain respects in conflict with the decisions of this court and of the courts of appeal of other circuits.

The grounds upon which the Southern Company based its application for *certiorari* are here reproduced for the convenience of the court with the facts brought down to date.

1. *Grave and serious questions affecting the rights of the petitioner are involved.*

An enormous judgment in favor of the Trust Company for over $700,000 (now $800,000) is imposed upon the Southern Company for the alleged reason that the reorganization plan, under which the latter acquired the Belt property, was "fraudulent" as against *assenting* creditors, although the Trust Company had been *benefited* by the plan to the extent of $1,480,909.20 in the exchange of its old securities (a large part of which, but for the plan, would have been a total loss) for the securities of the Southern Company, which it still retains. The Trust Company is permitted to claim *under* and *against* the same instrument.

This court in the *Boyd* case, referring to a similar reorganization, said that "the transaction would be *binding between the parties,*" and was only invalid as to "*non-assenting* creditors," yet the circuit court of appeals holds that the plan was sufficiently *valid* to enable the Trust Company to reap enormous benefits from it, but that it was sufficiently *fraudulent*, as a conveyance in fraud of creditors, to permit the Trust Company, which was a *consenting* creditor, to recover of the Southern Company its debt against the Belt Company. The doctrines of equitable election, ratification or estoppel, it is said, have *no application*.

In other words, although the Trust Company, by becoming a party to the plan, *consented* to the diversion of assets to stockholders which, it is said, should have gone to creditors, yet it is permitted to *base its action* against the Southern Company on the doing of the *very thing* to which it assented.

A rule so revolutionary, and so in conflict with settled principles and with decisions of this court should not, it is respectfully submitted, be given a fixed place in our jurisprudence until it has received the approval, after mature consideration, of the highest court in the land.

2. *Effect is denied to the solemn covenant of the Trust Company that it would not hold the Southern Company for the debt of the Belt Company.*

The substance of the covenant of the Trust Company (Rec., 822), which was supported by ample consideration, is quoted *supra*.

The obvious purpose of this covenant was to put security holders to their *election*. If they accepted the benefits of the plan they thereby waived the right to hold the new company liable for any debts of the old companies. The purpose was a lawful one. No rule of public policy is violated. The Trust Company, for an exceedingly valuable consideration moving to itself, and after balancing the advantages and disadvantages, accepted the plan, determining that its interests would best be served by accepting its benefits and by waiving any claim it might have to hold the new company for the debt of the old one.

The court of appeals holds that the Trust Company may *ignore* its covenant and enforce a trust, or liability or obligation of the new company for the debts of the old company, notwithstanding its agreement that it would not do so.

3. *The decision of the circuit court of appeals leads to alarming and disastrous consequences.*

(a) An equity "of at least $475,000.00" is *created* in the property of the Belt Company where *none* existed before. The bonded indebtedness of the Belt Company was $1,000,000 (Rec., 187), which was the amount of the purchase price paid by the Southern Company at the foreclosure sale. The master found

that, at the time of the foreclosure sale in December, 1901, after the reorganization was complete, all the properties involved then being operated together in one interest and as one system, its value (Rec. 852, 853), *did not exceed the mortgage indebtedness.* Furthermore, the floating indebtedness of the Belt Company *alone* at that time was $900,000 (Rec. 838).

By what just and logical process of reasoning can it be said that the Belt Company, under these circumstances, possessed an equity which could be subjected to the payment of a judgment in the sum of $800,000 to an unsecured creditor? If the Belt Company had no equity out of which the Trust Company's claim could be satisfied, how can the Southern Company be held?

It is not, we submit, any satisfactory answer to say that $4,750,000 par value of stock of the *Southern Company* had been previously issued to old stockholders of the Belt Company. That stock, prior to the foreclosure sale of the Belt Company, represented the physical property of the Gulf Company and its allied companies, *other than the Belt Company*, and only represented the *stocks and bonds* of the Belt Company (which property was only 3 1/3 per cent of the whole reorganization), and they could not have been worth more than the Belt Company's physical property, which the master valued at $1,000,000 at the time of its foreclosure sale.

(b) What would have been the result if the rule of the *Boyd* case, providing for a "fair offer" to unsecured creditors, had been followed at the time of this reorganization, and there had been issued to the Trust Company "preferred stock on equitable terms," which we will assume to mean dollar for dollar, taking the indebtedness (if it could have been ascertained at that time) and the stock at par, which is most favorable to the Trust Company, in view of the value of the property of the Belt Company and the amount of its secured and unsecured indebtedness. The Trust Company would have received $360,000 par value (its debt without interest) of preferred stock of the Southern Company, the average market value of which, during the year 1900 was $33.75 per share, making an aggregate value of $124,000. Add all the dividends that have been paid on the preferred stock (at four per cent during the past six years only) and interest thereon, and the result to date would be approximately $225,000.

The present market value of the preferred stock is $57.50 and on that basis the value of the Trust Company's holdings with dividends and interest thereon to date would be approximately $300,000.

The effect of the decision of the court of appeals is to award the Trust Company *over* $400,000 more than it would have realized to date if it had received "preferred stock on equitable terms" as a creditor, under the ruling in the *Boyd* case, which this court has said is the measure of its equitable rights.

The difference is so enormous as to at least suggest the necessity of some further consideration of the reasoning by which the court of appeals has reached its conclusion.

If the Southern Company is to be held liable at all (which we strenuously deny) should not the court *now* prescribe equitable terms, as of the date of the reorganization, instead of enforcing a judgment for the full amount with the accumulated interest?

A judgment awarding payment in full of the Trust Company's claim and accumulated interest is, we submit, without justification, in the absence of proof as to what was the equitable interest of the Trust Company in the reorganized property and without proof of its *pro rata* share therein.

(c) The court of appeals (210 Fed., 707), reaches the conclusion that the Southern Company paid in value "at least $475,000" for the equitable interest of the stockholders of the Belt Company in its property, and that this amount is available to creditors; and it concludes, therefore, that that interest was worth more than enough to have paid the $360,000 which the Belt Company owed to the Trust Company.

But the court apparently overlooks the *conceded fact* that the reorganization committee and the Southern Company paid out $1,164,172.56 (Rec., 859-860), on account of the floating debt of the reorganized companies. There is nothing in the present record to show how much of this was on account of the indebtedness of the *Belt Company*. There is nothing to indicate that the whole of the $475,000 has not been already paid to creditors. The fact that there was a diversion to stockholders of $475,000 which belonged to creditors, furnishes no guide as to what part of that

sum belonged to this particular creditor in the absence of proof of the total debts.

4. *The rulings of the court of appeals in two respects are in conflict with rulings of circuit courts of appeal in other circuits, and also with rulings of this court.*

(a) The ruling of the court of appeals in respect to the properties of the Central Company (201 Fed. 826), is adhered to without comment in the second opinion. The properties involved were purchased with the moneys of the mortgagor companies for rights of way needed by them respectively, the naked legal title being taken in the Central Company, whose stock was held by the mortgagor companies in the proportion in which their moneys went into the properties. The equitable title to the properties was thus in the mortgagor companies. Afterwards, and while the mortgagor companies held the equitable title to the properties themselves and also the corresponding stock of the Central Company, the stock of the Central Company was pledged to the Trust Company, which was trustee in all the mortgages, as collateral for *its* indebtedness. Before this pledge of stock of the Central Company occurred, the after-acquired property clauses of the mortgages of the mortgagor companies had attached in equity to the properties, and the title thereto afterwards passed to the Southern Company as purchaser at the foreclosure sales of the properties of the mortgagor companies.

In denying the Southern Company's title to the properties of the Central Company the court of appeals is in direct conflict with the following decisions of courts of appeal of other circuits.

Guaranty Trust Company v. *Atlantic R. R. Co.*, 138 Fed., 517, Third Circuit;

New England Water Works Company v. *Farmers' Loan and Trust Company*, 136 Fed., 521, Seventh Circuit.

And the court of appeals is also in conflict with the ruling of this court in the following cases:

Wade v. *Railway Company*, 149 U. S., 327, 341;
Central Trust Company v. *Kneeland*, 138 U. S., 414;
McGourkey v. *Toledo Ry. Co.*, 146 U. S., 536, 566.

(b) The Trust Company's exceptions to the report of the master (Rec., 893), were that:

> The master, in his report should have *omitted reference to* or *recommendation concerning* the question of the liability of the Southern Company for said floating indebtedness of the Belt Company for the following reasons.

The grounds specifically assigned were that that issue was *not in the case* for various reasons, but it is nowhere stated that the issue had been decided incorrectly. The assignments of error in the court of appeals followed the foregoing exception, the *deliberate purpose* of the Trust Company in its exceptions to the master's report, and in its assignments of error in the court of appeals, being to *avoid a decision* in this proceeding upon its merits of the question of the liability of the Southern Company for the floating indebtedness of the Belt Company.

The court of appeals holds that under these circumstances it may consider and pass upon this question of liability, and it did consider and pass upon it, notwithstanding the fact that the *correctness* of the master's conclusion that the Southern Company was not liable for the floating debt of the Belt Company went unchallenged before the master and before the circuit court.

The conclusion of the court of appeals in this respect is in conflict with the following decisions of the courts of appeal of other circuits:

> *Provident Life and Trust Co.* v. *Camden Ry. Co.*, 177 Fed., 854, 859, Third Circuit;
> *City of New Orleans* v. *Fisher*, 91 Fed., 574, Fifth Circuit.

And the court of appeals is also in conflict with the following decisions of this court:

> *Burns* v. *Rosenstein*, 135 U. S., 449;
> *Coghlan* v. *South Carolina Ry. Co.*, 142 U. S., 101, 115;
> *Topliff* v. *Topliff*, 145 U. S., 156;
> *McMicken* v. *Perrin*, 18 How., 507;
> *Metsker* v. *Bonebrake*, 108 U. S., 66, 72.

The question is important and material for the reason that exceptions to the report of the master (Rec. 913) were filed by the Belt Company upon the issue of debt or no debt as between

the Trust Company and the Belt Company. These exceptions were overruled, but the Belt Company did not appeal, for the reason that the Trust Company, in its exceptions and in its appeal, did not question the correctness of the finding of the master and the decree of the lower court, to the effect that the Southern Company was *not liable* for the indebtedness of the Belt Company. It was not until after the Belt Company had *lost* its right to an appeal upon the question of the existence or amount of the indebtedness between the Belt Company and the Trust Company that the court of appeals decided that it would determine and pass upon the *correctness* of the finding of the master and decree of the lower court upon the liability issue.

5. *Grave and serious questions affecting generally the reorganization of insolvent quasi-public corporations are involved.*

In the eighth judicial circuit, where the rule of the court of appeals is controlling, there are, at the present moment, eight railway companies in the hands of receivers appointed by the Federal Court, their aggregate outstanding stock and bond issue being as follows: (Poor's Manual as to all except the fifth company):

St. Louis & San Francisco R. R. Co.	$381,765,462.31
Wabash Railroad Co.	198,481,575.89
Kansas City, Mexico & Orient Ry. Co.	49,538,000.00
Missouri, Oklahoma & Gulf Ry. Co.	17,252,463.15
Metropolitan Street Railway Company	33,684,035.44
Chicago, Rock Island & Pacific	363,334,530.00
Missouri Pacific and Iron Mountain	432,705,003.59
Missouri, Kansas & Texas	281,084,300.00
Total	$1,757,845,370.38

These properties are in process of reorganization either actually or prospectively. Their aggregate outstanding *capital stock* issue is $522,424,985.25. The enormous value thus represented by the capital stock must be *destroyed* unless stockholders participate in the reorganization of these properties. Many difficult and vital questions are left unsettled by the *Boyd* case, and their proper determination has been rendered *more difficult* by the decision of the court of appeals in this case. Rights will be sacrificed and protracted litigation will result until there can be an authoritative answer given to certain vital and fundamental questions, among which may be mentioned the following:

(a) May a security holder exchange his securities under a plan of reorganization, and having done so, may he afterwards, notwithstanding the doctrine of estoppel, election and ratification, and without making restoration, recover from the new company for the debts of the old one, for the sole reason that stockholders are given an interest in the new company?

(b) Is it competent for a security holder who accepts the plan and exchanges his old securities for new ones to enter into a valid covenant to waive the assertion of any and all other claims against the new company by reason of his dealings with the old company?

(c) If a court shall hold, in some subsequent proceeding, that the terms offered to a non-assenting creditor fell short of being "equitable," will the court prescribe and enforce terms which it finds should have been offered, or will the creditor be entitled to enforce a money judgment against the new company for the face of his claim and accumulated interest? Can the reorganization committee invoke the judgment of some court to determine what will constitute "fair terms," or must it act at its peril?

(d) If the existence of a creditor be unknown at the time, and he subsequently appears and brings suit against the new company, or if his debt is disputed at the time, but is afterwards established, will the court permit the new company to offer the creditor such equitable terms as would have constituted a "fair offer" at the time of the reorganization, or must his debt and accumulated interest be paid?

(e) May a bondholder decline to come into a reorganization in which stockholders receive any benefit, accept his distributive share of the proceeds of the foreclosure sale, credit the same upon his bond and recover the balance against the new company, realizing both principal and interest in full, thus making it impossible to induce bondholders to come into any reorganization?

(f) What rule is to govern the "issuance on equitable terms, of income bonds or preferred stock" to non-assenting creditors? Should preferred stock or income bonds at par equal the face of the creditor's debt? If not, how should the proportion or ratio of

stock or bonds to debt, as well as the relative value of securities and debt, be determined?

(g) If stockholders are assessed as a condition to participation in the plan, may creditors also be assessed in a similar manner as a condition to the issuance to them of income bonds or preferred stock? Will creditors be denied relief, as stockholders are, if they fail to pay their assessment?

(h) If in an "adversary proceeding" it is determined that the valid mortgage indebtedness of the debtor equals or exceeds the fair value of the debtor's property so that there is, in fact, no equity out of which the debt can be satisfied, will the new company, nevertheless, be required to satisfy the debt if it issues its stock in exchange for the stock of the old company?

These and other vital questions are involved, directly or indirectly, in this case, and their proper and prompt determination is of immense importance to those charged with the duty of reorganizing insolvent railway properties who, on the one hand, should not unnecessarily sacrifice the interests of stockholders, and, on the other hand, should give due consideration to the protection of the rights of creditors.

We respectfully request that this brief, as well as the briefs heretofore filed by *amici curiae*, may be considered in support of our application for *certiorari*.

III.

The plan of reorganization is binding upon the Trust Company because it actively participated in the plan and greatly benefited by it in the exchange of its own securities in the old companies for those of the Southern Company. Equity will not permit the Trust Company to retain the benefits of the plan and at the same time attack it as fraudulent. It cannot claim both under and against the plan.

The participation of the Trust Company in the reorganization of the Gulf Company and its allied companies is one of the established and conceded facts in this case, and, we respectfully submit that it constitutes the broad and controlling equity against the claim here asserted that the Southern Company is liable for the debt of the Belt Company.

As before stated, the Trust Company received $1,480,909.00 par value of the securities of the Southern Company, *under the plan of reorganization*. Of this amount $517,199.00 par value represented *stock* of the Belt Company, the Dock Company and the Gulf Company, previously owned by the Trust Company, *which would have been a total loss to the Trust Company but for the reorganization plan*. The securities received by the Trust Company in exchange for *bonds* of the old companies were undoubtedly much more valuable *by reason of the plan* (Rec., 853), than would have been the distributive shares to which the Trust Company would have been entitled under a foreclosure sale.

The Trust Company not only exchanged its own securities but it was a trustee in all the mortgages under which the Southern Company acquired title and one of the depositaries under the plan, and actively supported it in every way possible. The master sums up the situation (Rec., 869) as follows:

> The Trust Company, a depositary in the reorganization plan, co-operated with the committee and used its influence by correspondence and otherwise, to induce other bondholders and stockholders to deposit their securities with the committee. *It was well acquainted with the purpose of the reorganization scheme and with such knowledge entered into the same, depositing its own securities and exchanging them for the new Southern securities, and advising others to make like exchanges.*

It is upon this state of facts that the Trust Company, for a recovery against the Southern Company for the debt of the Belt Company, invokes the doctrine of the Boyd case, 228 U. S., 482, which holds that a reorganization plan, participated in by both stockholders and bondholders, which makes no provision for the payment of unsecured debts,

(a) Is *binding* "between the parties," and *valid* "between the parties and the public generally;"

(b) Is void in equity as against a "*non-assenting* creditor," and

(c) May "bind creditors who do not accept fair terms offered."

We contend that, tested by this rule, the Trust Company was a *consenting*, and not a *"non-assenting"* creditor, and that the reorganization plan is "binding" upon it, and that it is not in a position to make the complaint which is sought to be made here.

What are the considerations which give rise to the rule that a railroad reorganization plan participated in by both stockholders and bondholders may be "void as to *non-assenting creditors,*" and at the same time "binding *between the parties?*" The answer is found in a consideration of the nature and the legal effect of the plan. If the plan operates to transfer some portion of the property to "the subordinate interests of the old stockholders," which in equity should go to the "superior rights" of creditors, the transaction is void as to *non-assenting* creditors as a conveyance in fraud of their rights, and the property remains subject to their claims as though no conveyance had been made.

The transaction is "binding between the parties" because all who *assent* to the transfer of an interest to stockholders, which in equity belongs to creditors, are bound by their assent, and cannot complain. Stockholders cannot complain because they are the beneficiaries; and creditors who have *assented* that stockholders, and not themselves, shall be the beneficiaries have no cause for complaint.

No rule of law is more firmly established than that a transfer of property made in fraud of creditors, while void as to them, is *binding upon the parties and those in privity with them.* (14 Am. &

Eng. Enc. of Law, 273; 20 Cyc. 608; *Whittiker* v. *Whittiker*, 157 Mo., 342, 353.)

It is equally well settled that a creditor who *participates* in, or *assents* to a conveyance fraudulent as to creditors, thereby elects to affirm it, and the conveyance is *valid* as to him, and he cannot be heard to assert that the transfer was fraudulent as to him. (14 Am. & Eng. Enc. of Law, 281; 20 Cyc. 434, 435.)

In this case the reorganization plan was binding "between the parties," and the Trust Company was not only a party to the plan, but it was one of its chief beneficiaries. It was as far removed from the position of a *non-assenting creditor* as it is possible to conceive. The plan, being binding on the Trust Company, cannot be attacked by it as a fraud upon its rights.

A close analysis of the effect of the plan and the result of the Trust Company's participation in it will serve to confirm this conclusion. When the Trust Company invokes the doctrine of the Boyd case it says in substance that some part of the property of the debtor, the Belt Company, was diverted from its unsecured creditors and given to its stockholders, this being accomplished by means of the exchange of stock whereby the old stockholders of the Belt Company, holding 47,500 shares of $100.00 par value each, received an equivalent amount, face value, in common and preferred stock of the Southern Company.

Let us assume for the sake of the argument (although it is in fact denied) that, as found by the court of appeals, $475,000.00 in value of the property of the Belt Company went to its old stockholders. What is the position of the Trust Company under this assumpion? By its participation in the plan and by its signature to the agreement it *assented* that $475,000.00 should go to stockholders, including itself, which in equity should have gone to the unsecured creditors, including itself. How can it now complain that this *was* done, in the face of its consent that it *should* be done?

Moreover it not only assented to this fraudulent diversion of assets (if it was a fraud, which is not admitted), but it actually *received and retains* its share of the fruits of the unlawful transaction, in the form of stock of the Southern Company which it received in exchange for its stock of the Belt Company. It seeks

to challenge the transaction as fraudulent and in violation of its rights, and at the moment of doing so *it has the money in its pocket* which represents its share in the proceeds of the alleged fraud.

By its *participation in the plan*, the Trust Company, in substance, said to all concerned in the reorganization, including the Southern Company:

(a) We consent that $475,000.00 in value of the property of the Belt Company (using for illustration the figures of the court of appeals), which in equity should go to unsecured creditors, including ourselves, shall go to the old stockholders, also including ourselves.

(b) We consent to the fraudulent diversion of assets from ourselves and other unsecured creditors, to ourselves and other stockholders of the Belt Company, which under the plan of reorganization enriches our treasury to the extent of one and one-half million dollars par value of the stocks and bonds of the Southern Company.

By its *attitude in this litigation* the Trust Company, in strange contrast to its position as a beneficiary under the plan, says to the court and to the Southern Company, in substance:

(a) The diversion to old stockholders, including ourselves, of $475,000.00 (again using for illustration the figures of the court of appeals), which in equity belonged to the unsecured creditors, including ourselves, was a breach of trust and a conveyance in fraud of *non-assenting creditors*, such as ourselves.

(b) We have been outraged and defrauded by this diversion of trust funds, notwithstanding it was a diversion to which we assented, and by which we have profited, and we invoke the aid of a court of equity for the relief to which in good conscience we are entitled.

Can anything be conceived which more pointedly violates the broad principle of fair dealing? How can the Trust Company *approve* the plan of reorganization and the exchange of securities *sufficiently to receive and retain the benefits therefrom*, and then *disapprove* to the extent necessary to collect its debt from the

Southern Company? Shall the Trust Company be permitted to *approbate* and *reprobate* at one and the same time?

It needs only the application of familiar rules to the conceded facts in this case to demonstrate that such inconsistent and antagonistic attitudes will not be tolerated.

IV.

The application of the doctrine of "quasi-estoppel" or of estoppel by the acceptance of benefits is fatal to any right of recovery on the part of the Trust Company.

By the overwhelming weight of authority the acceptance and retention of benefits under the reorganization plan prevents the Trust Company from claiming that the plan, or anything done under it, either *at the time* of its execution or subsequently, was in fraud of its rights as a creditor. It is not material whether the rule be called "estoppel" or "quasi-estoppel" or "estoppel by acceptance of benefits" or "equitable election."

The whole doctrine is concisely stated by Prof. Bigelow, 16 Cyc., 784, as follows:

> The term "quasi-estoppel" has been applied to certain legal bars which are in some respects analogous to estoppel *in pais* and which have the same practical operation as an estoppel *in pais*, but which nevertheless differ from that form of estoppel in essential particulars. The term includes the doctrine of election, the principle which precludes a party from asserting, to another's disadvantage, a right inconsistent with a position previously taken by him, and certain forms of waiver.
>
> Where one having the right to accept or reject a transaction takes and retains *benefits* thereunder, he becomes bound by the transaction and cannot avoid its obligation or effect by taking a position inconsistent therewith. Thus it has been repeatedly held that a person by the acceptance of benefits may be *estopped* from questioning the existence, validity, and effect of a contract. So, too, under similar circumstances, one may be estopped from questioning the existence, validity, and effect of a deed, mortgage, or bond, or of proceedings under which his property has been taken for a public or quasi-public use. In order to constitute an estoppel, however, the benefit received must be direct, and must have been voluntarily re-

ceived, and with a knowledge on the part of the person receiving it of his rights.

The rule is well expressed by the Court of Appeals of New York (*Wormser* v. *Metropolitan Street Railway Company*, 184 N. Y., 83), as follows:

> Where the objection to the acts of a corporation is that they are *ultra vires*, without being either *mala prohibita* or *mala in se*, a stockholder cannot maintain an action in his own behalf based on such objection, where he himself, with knowledge of the character of the acts, *has acquired and accepted pecuniary benefits thereunder*. Whether his conduct in so doing constitutes an estoppel in the strict sense of that term, or a quasi-estoppel, as Mr. Bigelow puts it (Bigelow on Estoppel [4th Ed.], c. 19), or be denominated merely an *acquiescence* or an *election*, or the *assumption of a position inconsistent with an attack*, makes no essential difference here. The point is that the seeking and acceptance of a substantial *benefit*, which would be unavailable to the stockholders, *except as a result of the acts which he would attack as ultra vires* preclude him from assailing those acts on that ground. A litigant is not at liberty to deny the validity of a contract, which is neither prohibited by law nor evil in itself, *after he has knowingly sought and obtained pecuniary advantages, pay or compensation, under and by virtue of such contract*.

The case there under consideration involved the reorganization of a street railway company. The plaintiff brought suit to prevent the carrying out of the reorganization plan on the ground that it was *fraudulent*. It appeared that after suit was brought the plaintiff *availed himself of the plan* by subscribing to the capital stock of the new company and then sold his option or privilege to third persons for over $5,000. He made the subscription under protest, claiming it would be only to preserve his rights (90 N. Y. Supp. 716). The court, after stating the general rule above quoted, held that he had ratified the plan of reorganization and was estopped, saying:

> This doctrine applies to the present case, and is conclusive against the maintenance of this action by the plaintiff. He has sold the privilege attaching to 885 of his Metropolitan Railway Company shares to subscribe to the stock of the Metropolitan Securities Company for between $5,000 and $6,000. *His privilege would have been absolutely nonexistent, except for the plan and lease which he attacks in this suit*. He was

well aware of this, and he cannot *avail himself of the privilege* and at the same time *prosecute the suit*. The officers of a corporation who are sued by stockholders for damages due to carrying on business not authorized by its charter may defend by showing the stockholders' acquiescence in or assent to the business, express or implied. *Holmes* v. *Willard*, 125 N. Y. 75, 82, 25, N. E., 1083, 11 L. R. A., 170

As was said by the Supreme Court of Alabama in *Robinson* v. *Pebworth*, 71 Ala., 240, estoppel in a case of this character "simply means that *you shall not take the fruits of an illegal transaction and afterwards set the transaction aside as illegal.*" In holding that the plaintiff here is precluded from attacking the plan and lease in question by reason of his sale of the privileges acquired by him thereunder as a stockholder in the Metropolitan Railway Company, we do not pass upon the legality of the scheme, either to condemn or approve it; we simply decide that, even *assuming it to be as unlawful* as he alleges, *he is in no position to assail it*. This defense is available to the respondents notwithstanding the fact that the plaintiff did not sell his privileges until after the beginning of the suit. Matters which arise between the bill and plea may be pleaded in equity.

In *Post* v. *Beacon Vacuum Pump & Electrical Co.*, 84 Fed., 371, 28 C. C. A., 431, the United States circuit court of appeals in the first circuit considered the sufficiency of a bill in equity filed by stockholders of the Beacon Vacuum Pump & Electrical Company to rescind a transfer of its property to the Beacon Lamp Company; and it was held that the complainants being minority stockholders who opposed the transfer were *estopped* from maintaining a suit for rescission on the ground of *ultra vires, because they had subscribed for their proportion of the stock of the new corporation*, although under protest, and had permitted such company to conduct the business for 18 months. The court said:

It is clear that the complainants have not maintained that consistent position necessary to relieve them against an equitable estoppel. They admit that they have subscribed for their proportion of the 32,000 shares of stock in the new corporation. They do not state the date when they made the subscription. The transfer of the assets to this corporation was made in July, 1895, and the bill was not filed until the 12th day of January, 1897, so that, although at the outset they protested against the reorganization, yet their subscriptions, in the absence of any proper allegation otherwise, must be pre-

sumed to have been made at such time as justified the respondents in assuming that the lamp company was authorized, so far as the complainants were concerned, to receive the transfer of the property of the old corporation, and to commence and carry on its manufacturing business, thus involving itself in the liabilities and other complications inevitably arising therefrom. *That this raised an estoppel in equity as against a bill praying rescission is too clear to need discussion.* It is true that complainants allege that this subscription was under protest, and only to preserve their rights; but the bill does not give the court any details which would enable it to perceive that, by any possibility, the effect of the subscription, which of itself would be an accomplished fact, could be overcome by any protest or other formal reservation which might accompany it.

In *Towers* v. *African Tug Company*, (L. R. [1 Ch., 1904] 558), which was a suit by two shareholders of the defendant to compel the directors to repay to the company the amount of a dividend illegally, though honestly, declared and paid, the decision of the Court of Appeal is accurately stated in the head note as follows:

> A shareholder in a limited company who has, with full notice or knowledge of the facts, *himself received part of the proceeds of an ultra vires act* committed by the directors—such as payment of a dividend out of capital—and who still *retains the money*, cannot, either individually or as suing on behalf of the general body of shareholders, maintain an action against those directors.

Lord Justice Vaughn-Williams, in the course of his opinion, says:

> If it be the fact, as I think it is, that these plaintiffs knew of all that had been done, *received their dividends* with knowledge of all the facts, and then brought this action *with the money still in their pockets*, ought they to be allowed to bring this action, which, as I have pointed out, is to my mind, an action such as they can bring in consequence of their personal interest in the matter? I think not. I think that an action cannot be brought by an individual shareholder complaining of an act which is *ultra vires if he himself has in his pocket at the time he brings the action some of the proceeds of that very ultra vires act.* Nor in my opinion, does it alter matters that he represents himself as suing on behalf of himself and others. I think that the reason which requires us to say he ought not to bring such an action equally requires us to say that he

ought not to be the peg upon which such an action is to be hung for the benefit of others.

Lord Justice Cozens-Hardy said:

> It seems to me to follow that a shareholder, *having the money in his pocket which he knows is wrongfully there*, ought not to be allowed to complain.

In the case of *International Contracting Co.* v. *Lamont* (cited as *United States* v. *Lamont*) 155 U. S., 303, 15 Sup. Ct., 97, 39 L. Ed., 160, a contractor's bid for dredging for the government was accepted by the engineers in charge, but the matter was held up by the Secretary of War. The work was readvertised, and pending this bid the contractor commenced a mandamus suit to compel the Secretary of War to sign a contract with him under his first bid. Before this suit was disposed of, the bids under the second advertisement were opened, and it was found that the same contractor was again the lowest bidder, at a price much lower than his first bid. Being again the lowest bidder, he obtained a contract for the work, and the mandamus proceeding was dismissed. The contractor then demanded of the Secretary of War that he should sign the contract awarding him the work under the first bid, which was refused. Thereupon the contractor again commenced a mandamus to compel the execution of a contract under the first bid. The court, after holding that mandamus would not lie in such a case, proceeded as follows:

> But, even if the writ of mandamus could be so perverted as to make it serve the purposes of an ordinary suit, the relator *is in no position to avail himself of such relief*. He entered of his own accord into the second contract, and has acted under it and *has taken advantages which resulted from his action under it*, having received the compensation which was to be paid under its terms. Having done all this, he is *estopped* from denying the *validity* of the contract. *Oregonian Railway* v. *Oregon Railway*, 10 Sawy., 464, 22 Fed., 245. Nor does the fact that in making his second contract the relator protested that he had rights under the first better his position. If he had any such rights and desired to maintain them he should have abstained from putting himself in a position where he voluntarily took advantage of the second opportunity to secure the work. A party cannot avoid the legal consequences of his acts by protesting at the time he does them that he does not intend to subject himself to such consequences.

In *North Chicago St. R. Co.* v. *Chicago Union Traction Co.*, 150 Fed., 612, 626, it is said:

> It seems, also, that the rule of inconsistent positions or quasi-estoppel applies as between the North and West and Union Companies. This subject is considered by Prof Bigelow in his recent article on estoppel in 16 Cyc. 782. It seems from an examination of many of the cases cited by him that, if a person avails himself of the benefit of a transaction, he cannot be heard to deny its validity. The same rule is held in *International Contracting Co.* v. *Lamont*, 155 U. S., 303, 15 Sup. Ct., 97, 39 L. Ed., 160 (cited as *United States* v. *Lamont*), and *Wormser* v. *Metropolitan St. R. Co.*, 184 N. Y., 83, 90, 76 N. E., 1036, Id., 98 App. Div., 29, 90 N. Y. Supp., 714. See also, *Brazee* v. *Schofield*, 124 U. S., 495, 8 Sup. Ct., 604, 31 L. Ed., 484, above referred to.

In *Farmers Bank* v. *Groves*, 12 Howard 51, the bank sought to avoid an agreement upon the ground of fraud on the part of one of the parties, the court saying:

> Assuming that there was (fraud by Collier in the transaction), the bank could not *avail themselves of it* for the purpose of avoiding their part of the arrangement and at the same time *hold on* to the mortgage as a security for Collier's indebtedness. There has been no offer to *surrender* the mortgage and vacate the agreement. On the contrary, it is claimed by them as an available security, held and relied on against Collier.

In *Compton* v. *Jessup*, 167 U. S., 1, it was held:

> Persons who procure or acquiesce in a decree of foreclosure reserving the rights of a lien claimant, and who participate in the *benefits of an early sale* thus secured, cannot *object* to the enforcement of the lien in the manner pointed out by the decree.

In *U. S.* v. *Hodson*, 10 Wall. 395, the court held:

> If a bond is liable to the objection taken in this case and the parties are dissatisfied, the objection should be made when the bond is presented for execution. If executed under constraint, the constraint will destroy it. But where it is voluntarily entered into and the principal *enjoyed the benefits* which it is intended to secure and a breach occurs, it is then too late to raise the question of its validity. The parties are estopped from availing themselves of such a defense.

In *Daniels* v. *Tearney*, 12 Otto, 415, the estoppel was applied in respect of a stay bond executed under a void act of the legislature. It was held:

> When a bond is voluntarily entered into and the principal *enjoys the benefits* it was intended to secure, and a breach occurs, it is then too late to raise the question of its validity. The parties are estopped from availing themselves of such a defense.

The court, referring to a similar case, said:

> In disposing of the case the court well said, "Upon what principal of exalted equity shall a man be permitted to *receive a valuable consideration* through a statute, procured by his own consent or subsequently sanctioned by him, or from which he derived an interest and consideration, and then keep the consideration and *repudiate* the statute?
>
> Not to apply the principle of estoppel to the bond in this case would, it seems to us, involve a mockery in judicial administration and a violation of the plainest principles of reason and justice.

In *Winslow* v. *Railroad*, 208 U. S., 59, it was held:

> By *accepting* the sum awarded in condemnation proceedings as the value of that portion of their lands actually taken, the owners are *estopped* to insist that the petition was not maintainable.

The circuit court of appeals of the eighth circuit, in the case of *Loy* v. *Alston*, 172 Fed., 90, held:

> One who has *recovered damages* on the ground that he has been induced by fraud to make himself liable to pay a promissory note is *estopped* from successfully invoking the maxim, "He who comes into equity must come with clean hands" to defeat the subsequent collection of the note in equity.

The court of appeals of the ninth circuit, in the case of *Shackleton* v. *Baggaley*, 170 Fed., 57, 59, says:

> How can the appellants enforce a mechanic's lien for work and services performed under a contract and under a notice of lien which was filed *under the contract*, and at the same time allege that the *contract was void?* They deny that it is the purpose of the suit to rescind the contract. They admit that they entered into an agreement to waive a mechanic's

lien. The evident purpose of alleging that the contract is void is to obviate the effect of that agreement. The argument is that the *fraud* practiced by the appellees, no matter when it was discovered, absolves the appellants from their obligation to file no lien, but leaves the contract *intact* in other respects. The proposition cannot be sustained. If the allegations of fraud are true, the appellants were thereby defrauded in the sum of $1,250. For this they had their remedy by an action for damages. They cannot, in a suit brought in equity to foreclose a mechanic's lien under a contract and a notice of lien *affirming the contract,* allege that, by reason of *fraud* discovered, we know not when, the contract or any part of it was rendered *null and void. Long* v. *Caffrey,* 93 Pa., 526; *Brezenski* v. *Neeves,* 93 Wis., 567, 67 N. W., 1125; *Pressed Brick Co.* v. *Barr,* 76 Mo. App., 380; *Pinning* v. *Skipper,* 71 Md., 347, 18 Atl., 659.

In *United States* v. *Morse,* 218 U. S. 493, it is held:

The validity of a decree for the sale of an infant's real estate for purposes of reinvestment, and of the order appointing a trustee to make the sale, and of the bond reciting the due appointment of such trustee, executed to secure the faithful discharge by him of his duties, is not open to question by one who voluntarily became a surety upon the bond, *thereby enabling his principal to obtain the proceeds of the sale.*

In *State* v. *Bank,* 95 N. W., 1116 (90 Minn., 150), it is held:

The Germania Bank, organized under the state law, having a capital of $400,000, par value $100 per share, became insolvent, and made an assignment for the benefit of its creditors. Pending such proceedings, the bank was reorganized by the judgment of the district court under the provisions of chapter 89, p. 109, Laws 1897; the capital being reduced to $200,000. As a part of the reorganization scheme, those stockholders who paid up an assessment of $75 per share received stock to the amount paid, at par, in the reorganized bank, the other 25 per cent of stock held by them being canceled. All stock upon which the assessment was not paid was forfeited and canceled.

Held, an original depositor, who, in consideration of his claim against the insolvent bank, received, as part payment, time certificates of deposit, and a certificate of stock in the bank as reorganized, and who, without objection, permitted the bank to reopen and transact business for the period of two years, is *estopped,* against a receiver of insolvency of the re-

organized bank, from repudiating the transaction upon the ground that the same was invalid or irregular.

In *Seminole Securities Co.* v. *Southern Life Ins. Co.*, 182 Fed., 85, it is held:

> A stockholder of a corporation brought a suit in equity on behalf of himself and all other stockholders to have the affairs of the corporation wound up, alleging that fraudulent mismanagement by its officers had rendered it insolvent. Receivers were appointed who brought a suit in another state for the cancellation of a contract made by such officers on behalf of the corporation, which suit was compromised and settled with the approval of the court; the receivers being paid a considerable sum. Thereupon notice was sent to all stockholders to come in and prove their holdings, and from the proceeds of the settlement of the receivers' suit a dividend of 20 per cent was paid to all stockholders. *Held*, that stockholders, who came in pursuant to such notice, proved their claims, and received their dividends, were *estopped* to afterward maintain suits to rescind their contracts of subscription for fraud and claim as creditors of the corporation the amounts paid for the stock or *to attack the validity of the settlement in the proceeds of which they had shared.*

In *Gaddes* v. *Pawtucket Institution for Savings*, 80 Atl., 415 (33 R. I. 177), it is said, p. 420:

> Where a stranger to the title, or one having only a limited interest in a tract of land, conveys the property to another by deed or mortgage, *and the owner receives the benefit of any part of the proceeds, knowing the facts, he is estopped to deny that the deed or mortgage conveys a good title.* And likewise, if the owner, though ignorant of the facts when he receives the proceeds, *afterwards* learns the truth, *his retention of the proceeds* thereafter *estops him* from disputing the validity and effect of the conveyance. *Brewster* v. *Baker*, 16 Barb. (N. Y.), 613, 618; *Kahn* v. *Peter*, 104 Ala., 523, 16 South., 524; *Ansonia* v. *Cooper*, 66 Conn., 184, 33 Atl., 905; 16 Cyc., 787-791. See, also, *Brewer* v. *Nash*, 16 R. I. 458, 17 Atl., 857, 27 Am. St. Rep., 749; *Robinson* v. *Bailey*, 19 R. I., 464, 36 Atl., 1126; *East Greenwich Inst. for Savings* v. *Kenyon*, 20 R. I., 110, 37 Atl., 632.

In the case of *Sage* v. *Finney*, 135 S. W., 996 (156 Mo. App. 30), Finney had paid the dues on a policy of insurance on an agreement that he, Finney, should receive $1,000 of the insurance, the

total of the policy being $2,000; when the policy became payable, Finney's payments, with interest at 6%, had amounted to about $1800; Finney, in accordance with a stipulation, was paid $1,000 and brought suit for the balance of the amount which had been paid by him, claiming that an agreement, by the terms of which one who did not have an insurable interest in the life of another should receive all or any precise amount of the insurance beyond such premiums and interest as the beneficiary may have invested therein, was invalid; Finney therefore claimed that he was equitably entitled to reimbursement for the total amount advanced by him. The court held that Finney could not claim the benefits of the contract to the extent of accepting the $1,000, relying on it as the basis of his suit, and *at the same time attack the contract as invalid*. The court says:

> Though it be that an invalid contract affords no grounds for an estoppel unless it has been fully executed by the parties, it is true as well that *one may not both claim under and against the same deed*. One may not appropriate to himself rights such as the equities asserted here which accrue alone *from the contract*, and at the same time *deny* the efficacy of the undertaking with respect to the rights of an adversary. If a person predicate his cause, as does Finney here, on a right accruing to him under a contract, he is estopped from denying such portions thereof as are against his interest, and this is true, though such portion be invalid, for he must take it *cum onere* or not at all. He is estopped from assuming such *inconsistent positions*. For an application of the principle where one has accepted the benefits of an invalid contract, see *Morris* v. *Hall*, 41 Ala., 510, 536, 537. In *Robinson* v. *Pebworth*, 71 Ala., 240, 247, the doctrine is stated to be that, *though the transaction is illegal, one may not claim both under and against the same title*. So, where one accepts the benefits of an invalid mortgage, it is determined that he is estopped to thereafter assert its invalidity. *Horton* v. *Davis*, 26 N. Y., 495. The identical principle finds application too, and is illustrated, in numerous instances where it appears persons have accepted benefits under invalid judicial proceedings, for it is said they may not thus *accept the benefits* of the judgment and *dispute its validity*. One must not be inconsistent in the positions he assumes, and, if he *claims the benefits* of such invalid proceedings, he is thereafter estopped to *assert their invalidity*. *Hoffmire* v. *Holcomb*, 17 Kan., 378; *Babbitt* v. *Corby*, 13 Kan., 612; *Pursley* v. *Hays*, 17 Iowa, 310; *Lee* v. *Gardiner*, 26 Miss., 521. For applications of the general principle to one

claiming both under and against the same deed, see *Jacobs* v. *Miller*, 50 Mich., 119, 15 N. W., 42; *Swanson* v. *Tarkington*, 7 Heisk. (Tenn.) 612, 614, 615. To the same effect, see Bigelow on Estoppel, (5th Ed.) 684; Herman on Estoppel, 1040, 1039. See, also *Board Supervisors* v. *Allen*, 99 N. Y., 532, 2 N. E., 459. As above stated, Finney has already received $1,000 of the fund; for, upon the Supreme Council paying the $2,000, $1,000 thereof was awarded to him under a stipulation, and plaintiff made no claim whatever thereto. Besides accepting benefits to that extent under the contract after suit was instituted, plaintiff predicates his entire right with respect to the greater portion of the $1,000 now in court *on equities accruing out of the contract*, and, so doing, he is *estopped to assert the invalidity of the limitation* therein prescribed fixing his interest at $1,000.

V.

The doctrine of equitable election is a complete bar to a recovery by the Trust Company.

We are not invoking a technical estoppel *in pais*, but the broad equitable rule, whether called estoppel or equitable election, or whether comprehended within the maxim that "he who seeks equity must do equity," which effectively prohibits a party to litigation from claiming *under* and *against* the same instrument—a rule thus stated by this court in *Peters* v. *Bain*, 133 U. S., 670, which was a case involving a voluntary assignment alleged to be in fraud of creditors:

> The doctrine of election rests upon the principle that he who seeks equity must do it, and means, as the term is ordinarily used, that where two inconsistent or alternative rights or claims are presented to the choice of a party, by a person who manifests the clear intention that he should not enjoy both, then he must *accept* or *reject* one or the other; ***and so, in other words, that one cannot take a benefit under an instrument and then repudiate it.***

In the recent case of *Merchants National Bank* v. *Sexton*, 228 U. S., 634, this court holds that one claiming the benefit of a contract will not be permitted to *approbate* and *reprobate* at the same time. It is there held:

> Creditors of a bankrupt seeking to enforce a contract between the bankrupt and its debtor, and the lien arising there-

> from, so far as the avails of certain collateral are concerned, may not *enforce* rights given under one provision of such contract and *repudiate* another provision where the two are under the contract indissolubly associated, the one being the complement of the other.

The doctrine of equitable election has given rise to rules which are peculiarly applicable to the case at bar, and which, when applied to its peculiar facts, result in the inevitable conclusion that no recovery in favor of the Trust Company can be permitted to stand. It is thus defined in 11 Am. and Eng. Encyc. of Law (2nd Ed.), page 59:

> Election in equity is a choice which a party is compelled to make between the acceptance of a benefit under an instrument and the retention of some property, already his own, which is attempted to be disposed of in favor of a third party by virtue of the same instrument. More comprehensively election is defined as the choosing between two rights by a person who derives one of them under an instrument in which a clear intention appears that he should not enjoy both.
>
> Thus, if by one clause of a will an estate is given to A, and by another clause of the same instrument an estate of which A is the owner is given to B, A must adopt one of two courses. On the one hand, he may elect to take under the will, in which event he takes the property devised to him by the testator, and B will take the property of A of which the will attempts to dispose; on the other hand, he may elect to take against the will, that is, to retain his own property, but if he does so he must make compensation to B out of the estate which is devised to himself, to the extent of the benefit which B would have derived from A's property under the terms of the will.

Although originally applicable to deeds and wills, the doctrine of equitable election has been extended to "contracts for a valuable consideration resting in articles" and to "contracts for value completed and executed by a conveyance and assignment," as is apparent from the following quotation from *Codrington* v. *Lindsay*, 8 L. R. Ch. App., 578, where it is said:

> But I conceive the true rule for the decision of this case to be that which is so well stated by Lord *Redesdale* in *Birmingham* v. *Kirwan*: "The general rule is, that a person cannot accept and reject the same instrument, and this is the foundation of the law of election, on which courts of equity

particularly have grounded a variety of decisions in cases both of deeds and of wills, though principally in cases of wills, because deeds being generally matter of contract, the contract is not to be interpreted otherwise than as the consideration which is expressed requires." The application of this rule is illustrated as to cases of voluntary deeds by *Llewellyn* v. *Mackworth* and *Anderson* v. *Abbott;* as to cases of contracts for valuable consideration resting in articles, by *Savill* v. *Savill* and *Brown* v. *Brown;* and as to contracts for value completely executed by conveyance and assignment, by *Bigland* v. *Huddleston, Chetwynd* v. *Fleetwood, Green* v. *Green, Bacon* v. *Cosby, Mosley* v. *Ward,* and *Willoughby* v. *Middleton.* In two of those cases—*Green* v. *Green* and *Willoughby* v. *Middleton*—the husband's father was a party to an ante-nuptial settlement, and part of the consideration proceeded from him. Another, *Chetwynd* v. *Fleetwood,* was a case of settlement for value, not between husband and wife at all, nor in consideration of marriage. In all of them the party who, claiming by a title not bound by the deeds, thereby withdrew part of the consideration for which the deeds were intended to be made, was held obliged to give up, by way of compensation, what he or she was entitled to under the deeds, or *ex converso* (as in *Chetwynd* v. *Fleetwood*) was held bound, if taking the benefit of the deeds, to adopt and make good the contract forming the consideration for those benefits, as to matters by which, without such election, he would not have been bound.

The conclusion of the court is thus expressed by Lord Selborne:

I conceive it to be the true result of the principle of election and of the authorities generally, that no such person can claim any benefit from that contract, when *sui juris,* except upon the footing of adopting and ratifying it as far as it does not already bind him, and that all equitable interests which such person takes under it stand in equity as a security for his adoption and performance in those respects of the agreement between the actual parties, as it is expressed in the deed.

Lord Justice James said:

It seems to me, therefore, that the only safe rule to guide the court in dealing with marriage settlements is to consider everything that is brought or expressed to be brought into settlement by anybody from any source as one aggregate trust fund. So considering it, it seems to me very easy and very right to read all the trusts thus: Out of the aggregate prop-

> erty settled, A is to have so much and no more, B is to have so much and no more, the issue are to have such interests and no more or other. Then, if by paramount title A or B or any of the issue takes out of the aggregate something other than the share or interest expressed to be given, he or she must take that in full satisfaction of the expressed share or interest. This would seem to me to give a very simple rule to which every one of the cases can be referred (except *Campbell* v. *Ingilby*, which I more than doubt the propriety of), and which is sufficient for the solution of the problem in this case. And it is really not adding anything to say 'and no more.' And it is far safer to adopt without qualification the rule that a person cannot claim under and against the same instrument than in a particular case to divide the instrument into parts, and to find that in legal construction the one part is not made clearly dependent on the other part or parts.

The rule is thus stated in the recent case of *Pitman* v. *Ewing*, in the House of Lords (Appeal Cases 1911, page 217):

> It is the law of Scotland, as of England, that no person can accept and reject the same instrument. Where, therefore, a deed or will professes to make a general disposition of property for the benefit of a person named in it, such person cannot accept a benefit under the instrument without at the same time conforming to all its provisions *and renouncing every right inconsistent with them.*

The doctrine of election which prevents the assertion of repugnant rights is but an extension of the law of equitable estoppel. (*Fox* v. *Windes*, 127 Mo., 502, 512; 1 Herman on Estoppel and *Res Judicata*, page 11.)

Let us assume for the purposes of the application of the doctrine of equitable election that the property of the Belt Company was, as the court of appeals held, a trust fund for distribution, first to lien creditors, secondly to unsecured creditors, and thirdly to stockholders. The operation of the plan was in substance to give to the Trust Company, *as a stockholder*, a portion of the trust estate upon condition that the Trust Company, *as a creditor*, would surrender to the stockholders that portion of the trust estate to which it, as a creditor, was entitled. If the plan of reorganization had been a will or a deed or contract under the terms of which the Trust Company, as a stockholder, would have received a benefit upon condition that it surrender to the stockholders its rights as

a creditor, then undoubtedly the doctrine of equitable election would have applied. The analogy between the two cases is complete. When the Trust Company elected to accept the benefits under the plan accruing to it as a stockholder upon the condition that it surrender to the stockholders the interest which as a creditor it would be entitled to, it thereby conclusively and forever elected to accept the benefits thus accruing to it as stockholder and it thereby also conclusively renounced its right to claim any benefits which might otherwise have accrued to it in its capacity as creditor.

The Trust Company is held in law to have *renounced* and *relinquished* every right *inconsistent* with the provisions of the reorganization plan and agreement. (2 Herman on Estoppel and *Res Judicata*, Sec. 1028, page 1156; *Fox* v. *Windes*, 127 Mo., 512; *Stone* v. *Cook*, 179 Mo., 534, 545.)

The Trust Company undoubtedly with due deliberation weighed its chances and opportunities in claiming under the plan of reorganization and accepting the benefits which it created for it at the expense of creditors, and thereby waived the assertion of its rights as a creditor independent of the plan and in antagonism to it. By the plan it was able to surrender $517,199.00 par value of stock of the old companies and to receive in lieu thereof the securities of the Southern Company which but for the plan would have been a total loss. In addition to this it received from the Southern Company nearly $1,000,000 par value of its stocks and bonds, the value of which were greatly enhanced by the plan. Doubtless it reached a wise conclusion in accepting the plan, but whether it did so or not, it then and there made its final election so that now, *with the money in its treasury* which arose from the surrender of rights to which it and other creditors were entitled, it cannot at this late day claim that the plan, either in its structure or in its execution, operated to deprive it of its rights as a creditor, or resulted in the imposition upon the Southern Company of a liability for the debts of the Belt Company.

Other illustrations of the operation of the doctrine of equitable election are given below.

In *Kavanaugh et al.* v. *Shacklett's Adm'r. et al.*, 69 S. E. 335, (111 Va., 423) it was held:

> A widow filed a bill in equity seeking sale of the property of her deceased husband and commutation of dower in place

of the dower interest given to her by the will, and upon this bill process as to all parties was sufficiently made. A cross-bill was filed as to which the decree recited that the adult defendants appeared in court by counsel and waived their right of process, and that the cross-bill was taken for confessed as to them. The record showed that those defendants, either personally or by counsel, participated in the dower proceedings from commencement to conclusion, that they signed an agreement of sale under the terms of court, consented to the widow's commutation of dower out of the proceeds, accepted for themselves their own full shares of the proceeds, and that during 10 years they had not questioned the conclusiveness of the proceedings. *Held*, that, even if counsel were not entitled, in the absence of special authority, to appear and waive process on the cross-bill, those parties were estopped by their subsequent conduct from taking advantage of any irregularities in the dower proceedings.

In *Savings Bank of Richmand* v. *Todd et al.*, 77 S. E. Rep., 446, (114 Va., 708) it was held:

Where a husband conveyed certain property for the benefit of his wife, in consideration of her release of dower in the residue of his estate, which was thereupon conveyed for the benefit of creditors, a creditor with knowledge, or means of knowledge, of the circumstances of the transaction, who participated in the sale of the husband's remaining lands free from the wife's dower, and received his share of the proceeds of the sale, making it impossible to place the wife in *statu quo*, could not thereafter maintain a bill to set aside the settlement to the wife as excessive.

The court said:

But the dismissal of the bill might also have been placed upon the equitable doctrine of election. A court of equity will not entertain a bill by a creditor to set aside a settlement on the wife as excessive where it appears that such creditor with knowledge, or means of knowledge, of the facts and circumstances attending the transaction goes into a suit to sell the lands of the husband free from the wife's contingent right of dower, and receives his just share of the proceeds of sale. His conduct has made it impossible to place the wife in *statu quo*, and he will be held to his election. *Kavanaugh* v. *Shacklett's Adm'r.*, 111 Va., 423, 427, 69 S. E., 335; *Peters* v. *Bain*, 133 U. S., 670, 695, 10 Sup. Ct., 354, 33 L. Ed., 696; 16 Cyc., 784.

VI.

The doctrine of equitable estoppel is also a complete bar to a recovery by the Trust Company.

The rule has been applied to participation by security holders in railroad reorganizations.

In *Farmers Trust Company* v. *Railway Company,* 120 Fed., 1006, the intervener was *both creditor and stockholder* in a company passing through reorganization. He exchanged his stock under the reorganization plan for the securities of the new company and then sought to hold the new company for a judgment against the old company. The court disposed of the contention briefly, and it is believed logically and concisely, by the use of the following language:

> The intervener here cannot be permitted *to blow hot and cold,* and having entered into the reorganization, he must be held to be bound by his action.

In *Matthews* v. *Murchison,* 15 Fed., 691, it was held:

> A bondholder of a former organization has no standing in chancery to dissolve the present organization of a railroad company, for which his agent had voted his bonds, it was alleged, in excess of authority, and to enforce a different plan, where it appears that he had known of what his agent was doing, but had not dissented, *and that he had accepted his share of the bonds of the new organization,* had offered to buy and sell, and had brought suit for them. *Such conduct ratified the act; or, inducing others to believe he had acquiesced in the organization, worked estoppel.*

In *Symmes* v. *Union Trust Co. of N. Y.,* 60 Fed., 830, it is stated in the syllabus:

> Stockholders who have had full knowledge of a plan of reorganization, and have given it their approval, and subscribed to its provisions in respect of part of the stock owned by them, *are estopped,* after the reorganization is complete, to maintain a suit, as owners of the stock on which they did not subscribe, to overthrow the same on the ground of fraud and conspiracy.

In *Vose* v. *Cowdrey,* 49 N. Y., 336, 343, the court said:

> He cannot be permitted to assert that the agreement of October 3, 1861, was fraudulent as to creditors and that he

is entitled to pursue the property on that ground, for he admits in his complaint that he was a party to and one of the trustees under that agreement, and that in pursuance of it he surrendered a large amount of bonds of the La Crosse & Milwaukee Railroad Company, thus entitling himself to the benefits of the agreement. *Being such party, he also necessarily assented to the issue of the new stock to the old stockholders.*

Other cases in which the same principle is recognized are given below.

In *Reagan* v. *First National Bank*, 157 Ind., 623, the facts were as follows:

Krag-Reynolds Co., while grossly insolvent, wished to make a mortgage upon its property to secure the claims of some of its creditors. The company had issued preferred stock to the amount of $50,000, of which two persons owned $25,000 each. The company was advised by its attorneys that under the laws of Indiana a corporation could not mortgage its assets without the consent of the holders of a majority of its preferred stock. A plan was adopted which contemplated the taking over, by the company, of this stock, issuing its notes therefor to the holders. One of the stockholders refused to accept a note for his stock unless the notes were secured under the contemplated mortgage. Accordingly, the company issued two notes, in the sum of $25,000 each, which were turned over to these two stockholders for their stock, and then executed the mortgage to a trustee, in which these two notes were secured upon the same basis as the claims of all other creditors which were listed therein. The facts upon which this suit was brought are very complicated, and there is no need of setting them out here. What is pertinent is the discussion of the court in its opinion of the status of all such creditors as assented to this mortgage and agreed to the preferences sought to be given them therein. The court held that the transaction was valid as between the parties to it, and that none of the creditors who agreed to it would be permitted to attack it upon the ground of fraud in giving these two stockholders preference over other creditors, instead of postponing their claim till the satisfaction of all the floating debts, as was provided by the statutes. The trustee under the mortgage was named Perkins. The court says, p. 585:

This mortgage is the source from which Perkins, as trustee, and the beneficiaries therein, claim and derive all of their rights and powers; and the directions given or stipulated in the instrument must be followed, so far as these parties are concerned, until set aside according to law, * *

It follows, therefore, that the court cannot direct Perkins, as trustee, to pay a debt of the mortgagor, or give it preference in violation of the terms and conditions of the mortgage, and the rights of the beneficiaries thereunder. As was said by the court *In re. Lewis, Supra,* 81 N. Y. 421: 'To hold the contrary would be to put the court in the place of the assignor, and assert a right to modify the terms of the assignment after it had taken effect, against the will of its maker and to the injury of those protected by it.' * * * *Where a debtor voluntarily assigns or transfers his property for security of his creditors, if the latter choose to accept the benefits of such assignment, they must abide by the provision and conditions imposed. They must accept its provisions as an entirety. They will not be permitted to accept it in part and repudiate it in part.*

In Bishop on Insolvent Debtors (Sec. 359) the author states the rule as follows: If the assignee is directed to pay certain persons upon certain specified amounts, either with priorities or proportionately, the assignee who accepts the trust, and all the creditors who come in and share under it, are bound by the provisions of the deed, and cannot dispute it. This proposition, which rests upon the doctrine of election, that he who accepts a benefit under an instrument cannot dispute the validity of its provisions, is abundantly sustained by the authorities * * * If the claims so provided for are fictitious or fraudulent, or such as for any reason ought not to be paid, that will be a ground for setting the assignment aside as fraudulent and void, but it will not furnish a ground upon which a creditor claiming under the assignment as a valid instrument can dispute the claim of another creditor provided for in the same manner in the same instrument.

Jessup v. *Hulse,* 21 N. Y. 168, was an action to set aside a conveyance of real estate upon the alleged ground of a fraudulent conveyance by one Hulse to Gott in trust for the benefit of creditors. Considering the effect of the provisions of the assignment, the court said:

The assignor, being the absolute owner of the property, and in no manner obliged to assign, may annex such

conditions and qualifications to the transfer as he pleases. If he annex an improper condition, the court must pronounce the assignment itself void. It cannot hold the transfer good, disregard the condition, because that would be to take the property from the assignor against his will. He having consented to part with his title only upon certain conditions, the transfer and the conditions must stand or fall together. *If, therefore, the court upholds the assignment, it must, of necessity, protect and enforce the terms and conditions upon which it is made. It cannot substitute its own discretion for that with which the assignor has in express terms invested the assignee.*

In *Bank* v. *Heckman*, 148 Ind., 490, 47 N. E., 953, the bank had accepted a mortgage executed to it by the Indiana Potter Company, the mortgage stipulating that it was subject to the provisions of a prior mortgage executed to Rosine Heckman and others to secure certain indebtedness. The question was as to the effect of the provisions of the prior mortgage upon this mortgage to the bank. The court held that the bank could not attack the prior mortgage as fraudulent, unless it abandoned its rights secured by the second mortgage. The court said:

> But the appellant bank was not seeking to set aside its own mortgage for fraud or anything else. It was seeking, so long as the first paragraph of its cross-complaint remained undismissed, to enforce its mortgage by foreclosing it. But that is not all it was seeking to do. It was seeking to enlarge the terms and conditions of its own mortgage contract by proving fraud against the first mortgage. *Fraud may furnish means to avoid one contract, but not to enlarge the terms of another, which would amount to the court making a new contract for the parties which they never made for themselves.* * * * It will be seen that the cases involving the question now under consideration do not rest upon the doctrine of estoppel in a strictly legal or technical sense, though some of the authorities referred to say that the second mortgagee is estopped to deny the validity of the first mortgage. But it is apparent that they all rest upon the principle that *a party seeking to enforce a contract in his favor must be bound and limited in his relief thereunder to the terms and stipulations of the contract.*

In *Jacobs* v. *Lumber Co.*, (Tex.), 15 S. W. 236, the syllabus of this case is as follows:

> Where certain persons buy property from an insolvent

> debtor, and pay him therefor, with the advice and consent of one of his creditors, the latter cannot claim, as against subsequent purchasers from the first purchasers, that the first purchase was fraudulent as to him, though the debtor intended without the knowledge of the purchasers not to use the proceeds from the sale in paying his debts.

In *Mitchell* v. *Mitchell*, 212 Pa. 62, it appeared that while indebted to his brother in the sum of $100, Mitchell made a voluntary conveyance of a piece of land to his wife, with the knowledge and consent of his creditor brother. Having recovered judgment against his brother on the claim, the latter condemned and sold the land as that of the debtor brother. Having received a deed from the sheriff to the land, he brought this suit to clear his title. The court made short work of the case:

> The principle *volenti non fit injuria* is a good defense to what would otherwise be actual fraud (*Zuver* v. *Clark*, 104 Pa. 222); and *a fortiori* it is good against merely constructive fraud. The jury have found that the plaintiff knew and assented to the conveyance by the defendant to the latter's wife. That ended the plaintiff's case.

Olliver v. *King*, 8 De G., M. & G., 110, is a leading English case upon the subject. It was decided in 1856. With the advice and concurrence of his brother, a father executed a voluntary conveyance to his sons. He was largely in debt to the brother at the time. In his will he made this brother and the sons trustees. For seven years after the death of the testator the brother acted under the will, never making any effort to impeach the deed. Upon his death, his representatives attempted to have this deed declared void as fraudulent against creditors. The court held that his representatives could not so impeach it, since he would have been estopped to do so himself. Lord Justice Knight Bruce and Lord Justice Turner delivered concurring opinions. We quote from that of Lord Turner, 114 Rev. R. 54:

> It is, however, said that James had a right to make a settlement of the property, subject to his debts. No doubt he had; and if he had made a settlement without John's concurrence, John might unquestionably have impeached it. But the question to be considered is, not whether James had a right to make the settlement, but what is the effect of John's concurrence in the settlement. Suppose John had executed the deed for the purpose of testifying his consent to the trans-

fer of the leasehold property by that deed, could he then have impeached the deed? I apprehend that he clearly could not; and if he could not, there is nothing which he has done falling short of the execution of that deed, except that there is not his pen put to the paper by which that property was transferred.

I think therefore that, as he could not have impeached the deed if he had actually executed it, neither could he have impeached it under the circumstances of concurrence on his part, which are in evidence in this case. If he could not have impeached it, of course his executors cannot. Even if he could have done so I am not satisfied that his executors could. * * * I give no opinion, however, on that point, further than to say I am not satisfied upon it.

My opinion is based upon this: I consider the true effect of this transaction to be, that John by his conduct agreed to this alienation of the assets, and must be considered to have consented to take satisfaction out of the property which remained.

In *Perisho* v. *Perisho*, 71 Ill. App. 222, it was held:

Where parties enter into an arrangement for the conveyance of real estate of one of them, for the purpose of hindering and delaying creditors, at the same time reserving a secret trust for the benefit of the grantor, according to well settled principle, the law will leave them in the position they make for themselves, and will not set the conveyance aside at the request of a creditor who was a party to the arrangement.

In *Rapalee* v. *Stewart*, 27 N. Y. 310, a creditor had entered into an agreement with the assignees in regard to the management of the assigned property, which agreement had been partly performed. The creditor later attempted to question the validity of the assignment.

The court, per Marvin, J., said:

The statute declares an assignment, made with intent to hinder, delay or defraud creditors, void, as to the persons so hindered, delayed or defrauded. Why is such an assignment void? It is because the effect of it is to delay or defeat creditors in the collection of their debts, and when made with such intent it is void. But if the creditors consent to the assignment, how can it be said that they are defrauded? One cannot predicate fraud of facts having his assent upon a full knowledge of them. It is true, in this

> case, the plaintiff was not consulted, at the time the assignment was made, but on being advised of its provisions he acquiesced in them, and entered into an agreement with other creditors, showing an assent to and ratification of the assignment; by which agreement the parties to it consented and agreed that certain other persons, one of them being the assignor debtor, should be joined with the assignees, and should convert and dispose of the property, and pay the creditors in the order of preference mentioned in the assignment. Here is not only a waiver of any right to attack the assignment for fraud, but a ratification of it by coming in and taking action, by agreement with other creditors, designed to prevent a sacrifice of the assigned property, by a disposal of it in the ordinary way by the assignees; and by the agreement authorizing further delays, compromises, etc. *It would be a fraud upon all of the other creditors to this agreement if the plaintiff should be permitted to maintain this action, and by setting aside the assignment gain a preference above them and secure the payment of his entire debt. I think that the plaintiff was concluded by his acts in reference to the assignment from attacking it on the ground of fraud as to creditors.*

In *Canton, etc.*, v. *Rolling Mill Co.*, 155 Fed., 321, the Rolling Mill Co., upon the advice and solicitation of one Sturgiss, conveyed all its assets to the Morgantown Tin Plate Co., a new corporation organized for the purpose of taking over the other. Sturgiss participated in the transaction as a stockholder in the new corporation. The Canton Roll and Machine Co., a creditor of the first corporation, brought a creditor's bill to set aside the conveyance as fraudulent and likewise to cancel the bonds issued by the new company, which sought to create liens upon the corporate assets. Later Sturgiss filed a petition in the cause, seeking to be made a party, alleging among other things, that since the commencement of the suit he had purchased the claim of the original complainant along with others, and asking that a first lien be declared for this original demand of the plaintiff on the funds arising from the sale of the property, which was in the hands of a trustee in bankruptcy. In deciding that he did not have any claim for the relief asked, the court said, p. 330:

> It seems to me clear that this controversy no longer exists between the original plaintiff in interest and the defendants; that its claim has either been paid by or assigned to petitioner George C. Sturgiss; that the allegations of the

original bill charging the transfer of the property of the Rolling Mill Company of America to the Morgantown Tin Plate Company to be fraudulent must fall and drop out of the case, for it is conceded that the organization of the Tin Plate Company and the transfer to it from the Rolling Mill Company of its property and assets was not only known and consented to by Sturgiss, but that all the papers and proceedings necessary to accomplish this result were either prepared or supervised by him as attorney for the parties interested in the two companies; and it is further admitted that he, by transfer from Humbert on the organization of the Tin Plate Company, became a stockholder of the Tin Plate Company; that he consented to be one of its original incorporators, but was not finally called upon to be such. Under such condition of affairs, it being uncontroverted that he owns the plaintiff's debt, either by assignment or payment, and that this creditor alone has made these charges of fraud, it would be a matter of supererogation to cite authorities to the effect that he is estopped from maintaining himself or having his assignee maintain them for his benefit.

In *Thompson* v. *Cohen*, 127 Mo., 215, the syllabi are as follows:

1. A deed, although in fraud of the grantor's creditors, is not a nullity; it is valid as between the parties and can be avoided only by creditors and subsequent purchasers.

2. A creditor who knowingly acquiesces in a sale and accepts benefits arising from it cannot afterwards assail it on the ground that it was made in fraud of creditors.

Judge Gantt, in the leading opinion, says, p. 227:

It has been generally held, both in England and the various states in this Union, that if a deed is made which a creditor may avoid if he sees fit, yet if he knowingly acquiesces in a sale and accepts the benefits arising from it, he cannot repudiate it.

Gutzweiler v. *Lackman*, 23 Mo., 168.

To a similar effect are:

Smith v. *Espey*, 9 N. J. Eq., 160;
Richards v. *White*, 7 Minn., 345;
Fiske v. *Carr*, 20 Me., 301.

VII.

It is respectfully submitted that no sufficient answer is given in the first opinion of the court of appeals to our contention that the Trust Company, by its conduct, is estopped to claim that the Southern Company is liable for the debt of the Belt Company.

The court of appeals, in its first opinion in this case, held that our contention that the Trust Company was estopped by its conduct to maintain its claim against the Southern Company should be denied upon the ground that "the Trust Company may well have supposed that its claim * * would be paid by the committee." The full text or what is said on this subject, 201 Fed. 823, is as follows:

> The contention of the Southern Company that the Trust Company is estopped from enforcing and collecting this claim based on the unsecured debt of the Belt Company to it, because, for the bonds and stock of the Belt Company, which it owned, it received bonds and stock of the Southern Company under the plan of reorganization, is untenable. The collection of this claim is not an avoidance; it is an enforcement and execution of the scheme of reorganization and of the trust in favor of the creditors of the Belt Company, which that scheme created. The published plan of reorganization was plenary notice under the law to the Southern Company, and to all who became interested under that plan, that purchasers of property of the companies foreclosed pursuant to it took that property in trust for the unsecured creditors of those companies. That plan expressly set apart $475,000 to be applied to the payment of the floating debts of those companies, vested in the committee of reorganization discretionary power to pay such of those floating debts as it saw fit to discharge, and that it actually expended $1,164,172.56 in paying such debts. The committee had full authority to pay this claim of the Trust Company. *The Trust Company may well have supposed that its claim, as well as the claims of other creditors of those foreclosed companies, which were paid to the amount of over a million dollars, would be paid by the committee.* The Trust Company never represented that it would not, but persistently asserted that it would enforce its demand, and the collection of it from the Southern Company is neither barred by estoppel nor inconsistent with the previous position and action of the Trust Company.

There is, we submit, absolutely nothing in the plan nor in the record which can be pointed to as justifying the assumption, indulged in by the court, that the Trust Company may well have supposed that its claim would be paid by the committee.

On the contrary, the record affirmatively shows that no such presumption can be indulged. In fact, the court of appeals, in its second opinion, abandons the position taken in its first opinion upon this subject, and places its denial of our claim of estoppel upon *an entirely independent ground,* which is presently to be considered.

(a) The claim of the Trust Company that it was represented to it that its debt from the Belt Company would be paid, was expressly made in the Trust Company's answer; and the master, in his report, expressly found *against* this claim. The allegation of the Trust Company in this respect (Rec. 200) is as follows:

> Said reorganization committee when working out said plan of reorganization expressly *represented* to this respondent that, in consideration of the debt due and owing from said Belt Company to this respondent, said committee would provide for the payment of all debts and obligations due to this respondent from all of said corporations proposed to be included in said reorganization plan, and particularly said Belt Railroad Company, and expressly *promised* this respondent that said committee would pay or cause to be paid all debts of every character due to this respondent from several corporations proposed to be consolidated, and particularly from said Belt Railroad Company; and that the said new and reorganized company would pay such debts.

The master, in his report, after a review of all the evidence upon the subject finds that there was *neither representation nor promise.* He says (Rec. 862):

> The alleged liability of the Southern Company arising on account of any *promise or agreement* by either the committee or the Southern Company to pay the Belt debt to the Trust Company is not satisfactorily supported by the proofs in the record.

The master further finds (Rec. 866), that there is no proof in the records of the committee or elsewhere of any authority having been given by the committee to Max Pam, or to any other person,

By which he or such person would be warranted in making a *promise or representation* which would be binding on the committee, even if any such promise or representation had been attempted to be made and for sufficient consideration.

The master, after an examination of the minutes of the committee (Rec. 864), reaches the following conclusion:

It will be seen that at no time did the committee, either directly or indirectly ever agree to pay in whole or in part any of the indebtedness of the Belt Company to the Trust Company.

(b) The Trust Company was not justified in *supposing* that its claim would be paid in view of the testimony of its general counsel, and later its president, T. L. Chadbourne (Rec. 862-864) who testified that one of the reorganization committee agreed to pay the claim of the Trust Company on *June* 16, 1900, and that it was not paid at that time as agreed. Notwithstanding the nonpayment of the debt on June 16, 1900, the Trust Company nevertheless, on *July* 26, 1900, exchanged its securities with full knowledge thereof.

(c) Nor had the Trust Company any reason to suppose that its debt would be paid out of the $475,000.00 which was a tentative appropriation of the proceeds of securities to be issued by the new company for the purpose of satisfying claims and liens against *all* the companies, so as to make the new mortgage a first lien on all of the properties brought into the reorganization.

The purpose and effect of the provision in respect to the proposed appropriation of $475,000.00 for paying floating debts is thus stated by the master (Rec. 854):

As heretofore stated, the reorganization agreement gave the committee plenary power to alter or modify the terms as might seem necessary or desirable, the intention being to include the Belt terminals, as heretofore stated, if sufficient of its securities were deposited with the committee, otherwise, arrangements for other terminals at Kansas City were to be made. The provision in the plan, as to using $475,000.00 for paying floating debts of the constituent companies, was, perhaps, more in the nature of a *detail* in the general plan, so as to advise the depositing security holders of the *probable disposition of the moneys*, to be realized from the securities to be issued by the new company, as there is nothing in the

plan, or in the agreement indicating the amount of the floating debts to be paid, or their nature *and certainly nothing as to the Belt indebtedness to the Trust Company*. The provision in the plan relating to certain securities, aggregating $3,000,000, and reserved in the treasury for future requirements, might properly be considered as another such detail in the plan.

And the following, (Rec. 860).

> The testimony of Shipley, Smith, Petitt, Pam, Harrity, Sielcken and Hecksher, members of the reorganization committee, and found in Vol. 57 of the record, is to the effect that the $475,000.00 appropriated, as above stated, for the payment of floating debts, was a lump sum set aside by the committee to make provision for the payment and discharge of such obligations as the committee might find necessary to discharge in order to relieve the properties to be included in the Southern mortgage, from any *liens*, claimed thereon or from any interference as a matter of business policy, and that said $475,000.00 was simply an *estimate or reservation* to cover such charges, and further, that at no time did the committee, in making such estimate contemplate or include therein the indebtedness of the Belt Company to the Trust Company; *but the contracting parties to the reorganization plan and agreement, made an express provision, intending to exclude, and excluding, the Trust Company or any other creditor of the constituent companies from enforcing against the new company to be formed, any right of action which such creditors might have had against the old companies.*

The fact that the estimate of $475,000 for the payment of liens and claims against the property, as well as the estimates contained in the plan, for the payment of car trust certificates, first mortgage coupons and receivers' certificates, were all largely exceeded, is set forth in the master's report (Rec. 859, 860) which is quoted in the statement. The purpose of all the payments made on floating debt account, as the Trust Company must have known, was to make the mortgage of the Southern Company an absolute first lien. Not only was the Trust Company's claim not of this character, but it, as a stockholder and bondholder, received, undoubtedly, the benefit of the payments made. The master says (Rec. 860):

In other words, the Trust Company, presumably, received its proportionate benefit from this large expenditure in payment of what are called the floating debts, but which in reality consists of all kinds of items, which the Committee deemed necessary to take care of, so as to secure absolutely the first mortgage lien on the properties transferred to the Southern Company.

(d) There is yet another reason why it is not possible that the Trust Company was justified in supposing that its debt would be paid from the proposed appropriation of $475,000.00 for floating debts, which applied to *all* of the companies involved in the reorganization, of which the Belt Company, measured by its relative bonded indebtedness, was but three and one-third per cent. The floating debt of the Belt Company *alone* was approximately $900,000 (R. 755). While the floating debt of the other companies, including the Gulf Company, involved in the reorganization does not appear, yet it may be assumed that it was considerable, but, whether large or small, how was the Trust Company warranted in assuming that its debt would be paid, when there was but a proposed appropriation of $475,000 to pay the floating debts of *all* the companies, and the floating debt of the Belt Company alone was $900,000?

It will not do to say that the Trust Company might well have supposed that its debt would be paid from some other source than the $475,000 provision, for the reason that all the bonds and all the stocks to be issued were accounted for under the terms of the plan, and no funds would be available for that purpose unless estimated expenditures for other purposes were correspondingly decreased.

(e) A well established rule of law forbids that the Trust Company shall be permitted to relieve itself of the effect of its act by "supposing," even if it did so, that its debt would be paid. A "supposition" entertained by it, whether or not communicated to the committee or to the Southern Company, could have no greater operation or effect than a *formal protest*, and the authorities are uniform to the effect that where a person's conduct is such as to operate an estoppel, the estoppel will be applied *regardless of the fact that he may protest and insist that it shall not have that effect*. This court says in *United States* v. *Lamont*, 155 U. S., 303:

> A party cannot avoid the legal consequences of his acts by protesting at the time he does them that he does not intend to subject himself to such consequences.

In *Wormser* v. *Metropolitan Street Railway Company*, 76 N. E., 1036, a participant in the reorganization plan subscribed to the stock of the new company, and afterwards sold his privilege, protesting "that the exercise of the privilege was without prejudice to his asserted rights with respect to the subject matter of this present suit," (90 N. Y. Supp., 716). But the court disposed of his protest with this statement, "but this cannot avail him."

So also in *Post* v. *Electrical Company*, 84 Fed., 371, the complainants alleged that their subscription to the stock of the new company was under protest and "only to preserve their rights," but this was held to be unavailing.

(f) The provision of the plan which made a tentative appropriation of $475,000 for the payment of floating debts of all the companies was not a contract for the benefit of the Trust Company, as a creditor, upon which it was entitled to maintain an action. The purpose and intention of this provision was to benefit the security holders and not to benefit the unsecured creditors of the constituent companies. That unsecured creditors may have been incidentally benefited does not change the rule or extend the contract to strangers not in privity with it. This court, in *German Alliance Insurance Company* v. *Water Company*, 226 U. S., 220, upholds the rule for which we are contending, using the following language:

> Before a stranger can avail himself of the exceptional privilege of suing for a breach of an agreement to which he is not a party, he must, at least, show that it was intended for his direct benefit. For, as said by this court, speaking of the right of bondholders to sue a third party who had made an agreement with an obligor to discharge the bonds, they "may have an indirect interest in the performance of the undertakings. * * * But that is a very different thing from the privity necessary to enable them to enforce the contract by suits in their own names."

The same rule is followed in the following cases:

St. Louis v. *Contracting Co.*, 202 Mo., 451;
Brattie Manufacturing Co. v. *Clark*, 208 Mo., 89;

Howsman v. *Water Company,* 119 Mo., 304;
Metropolitan Trust Company v. *Topeka Water Co.,* 132 Fed., 702;
Allen Manufacturing Co. v. *Shreveport Waterworks Co.,* 37 So., 980;
Second National Bank v. *Grand Lodge,* 98 U. S., 123;
Keller v. *Ashford,* 133 U. S., 610;
Sayward v. *Dexter,* 72 Fed., 758;
American Bank v. *Railroad Co.,* 76 Fed., 130;
Moyer v. *Railroad Co.,* 132 Ind., 88;
Freeman v. *Pennsylvania Co.,* 173 Pa. St., 274;
McIlvaine v. *Lumber Co.,* 54 S. E., 473;
Armour v. *Construction Co.,* 78 Pac., 1106.

The Trust Company must have known that as a creditor it was not entitled to maintain any action upon the floating debt provision, and, therefore, there was no legal justification for it to suppose that its debt would be paid.

VIII.

We respectfully submit that no sufficient answer is given in the second opinion of the court of appeals to our contention that the Trust Company, by its conduct, is estopped to claim that the Southern Company is liable for the debt of the Belt Company.

In the second opinion of the court of appeals it is held that the Trust Company is not estopped by its conduct, and the reason assigned is that the case is not brought within the narrow limits of a technical estoppel *in pais,* notwithstanding the fact that we do not now claim, and never have claimed, that this restricted form of estoppel is controlling in this case. It has at all times been insisted by the Southern Company that the estoppel, which is a complete bar to the assertion of the claim of the Trust Company, is that which arises from the acceptance and retention of benefits under the reorganization plan, and from the election which the Trust Company made between inconsistent positions.

Biglow on Estoppel, (6th Ed.) p. 732;
16 Cyc. p. 784.

The opinion does not disclose what views were entertained by the court of appeals upon the vital and controlling question,

further than the conclusion reached by it upon the subject of a technical estoppel *in pais* as follows, (210 Fed. 718):

> But counsel argue that the Trust Company is equitably estopped from maintaining its claim by the fact that it was one of the depositories under the reorganization agreement, that it persuaded others to sign it, and that on July 26, 1900, it exchanged its $76,972 par value of stock in the Belt Company and the stocks and bonds which it held in the Gulf Company and the other reorganized companies for $1,480,909 par value of stock of the Southern Company. Let us see: the indispensable elements of an "estoppel *in pais*" are: (1) intentional or reckless misrepresentation of a known and material fact inconsistent with the subsequent claim of him who makes the misrepresentation: (2) ignorance of the truth and absence of equal means of knowledge of it by the party who claims the estoppel; (3) action by the latter induced by the misrepresentation; and (4) injury to the latter if the truth is permitted to be proved. Biglow on Estoppel (4th Ed.) p. 679; *Illinois Trust & Sav. Bank* v. *City of Arkansas City*, 76 Fed. 271, 293, 22 C. C. A. 171, 193, 34 L. R. A. 518; *Farmers' & Merchants' Bank* v. *Farwell*, 58 Fed. 633, 638, 639, 7 C. C. A. 391, 396, 397; *New York Life Ins. Co.* v. *McMaster*, 87 Fed. 63, 66, 67, 30 C. C. A. 532, 535, 536. The estoppel here probably lacks all, and it certainly lacks at least three, of these essential elements: (1) the requisite misrepresentation of any material fact which the Trust Company knew; (2) ignorance or absence of equal means of knowledge of that fact by the Southern Company or its stockholders and bondholders, and (3) injury to them if the truth is permitted to be proved.

Then follows the reasons assigned by the court in support of its position that there was no misrepresentation by the Trust Company, that there were equal means of knowledge on the part of the Southern Company, and that no injury would result by granting to the Trust Company the equitable relief demanded by it. It is not deemed essential to follow the reasons of the court further than to point out that one conclusion of fact upon which they are based arises from a misapprehension. The court says:

> The Trust Company presented its claim against the Belt Company to one of the committee and was told before it made its exchange that the indebtedness of the Belt Company was denied, but was under investigation, and that when that in-

> vestigation was completed he would take up the claim and see if anything could be done about its settlement, *and there the matter rested until after the exchange of stock was made.* * * * * Neither the committee nor the Southern Company ever declared before the Trust Company exchanged its stock and bonds that they would not settle or pay it if the Belt Company really owed it.

It appears from the report of the master (Rec. 862) that the general counsel, and at one time president of the Trust Company, who was the witness chiefly relied upon by it, testified that Max Pam, one of the reorganization committee, promised to pay the debt of the Belt Company on June 16, 1900. The master also found (Rec. 866), that there was no proof anywhere in the record of any authority having been given by the committee to Max Pam, or any other person.

> By which he, or such person, would be warranted in making a *promise or representation* which would be binding on the committee, even if such promise or representation had been attempted to be made and for a sufficient consideration.

It was *after* the non-payment of the debt, on June 16, 1900, that the Trust Company, *on July* 26, 1900, exchanged its securities under the plan of the reorganization. It must be taken as true, therefore, not only that *no member* of the reorganization committee had authority to make a binding representation, but upon the Trust Company's own theory that a representation was made that the debt would be paid on June 16, 1900, it, with full knowledge that the payment had *not* been made, nevertheless accepted the plan and exchanged its securities under it. It is respectfully submitted, therefore, that the reasons assigned by the court of appeals were based on a misconception of the record.

Unquestionably, to constitute an estoppel, such as is insisted upon in this case, an intentional or reckless misrepresetation of a known and material fact is *not* one of the "indispensable elements;" nor is ignorance of the truth or absence of equal means or knowledge of it by the party who claims the estoppel, likewise an "indispensable element." The text books and decisions, alike, concur in their support of this statement.

In *Hector* v. *Mann*, 225 Mo., 228, coparceners were brought into court in a partition suit, by order of publication, and af-

terwards accepted their respective shares of the proceeds of the sales made in the proceeding. It is held that they were estopped from claiming that the partition sale was invalid. The important distinction betwen an estoppel *in pais* and an estoppel by acceptance and retention of benefit—which we respectfully submit was overlooked by the court of appeals—is there forcefully pointed out. The court said:

> But is argued that in order to operate as an estoppel the purchaser should have *known and relied upon* the receipt of the purchase money and changed his situation to his disadvantage because of such reliance. I cannot agree such argument is sound. There are estoppel and estoppels, and some forms of them are so defined by law-writers and jurists as to make one element in the estoppel the knowledge and reliance of one party upon the acts and conduct of the other—for instance, estoppel *in pais*, arising from misrepresentation by word, act, conduct or silence. But there are other forms of estoppel in which knowledge of the fact upon the part of the person invoking the estoppel, and reliance upon the fact and a change of situation based upon that reliance, *is not an element*. It may be that "estoppel," speaking with precision, is the wrong designation and that in attempting to classify and give names the doctrine we are about to invoke is improperly classified as "estoppel" and that it does not come under that head, but springs from election, ratification, affirmance, acquiescence, acceptance of benefits or what not. It is classed, however, by law-writers under the head of "quasi-estoppel." (Bigelow on Estoppel (5 Ed.), p. 693; 16 Cyc., p. 787 *et seq.*)
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> Says Bigelow: Many of the cases upon this subject it will be noticed, are simply cases of ratification or acquiescence; and it is a questionable use of terms, as we have seen, to apply the word 'estoppel' to them. A few more cases will serve to enforce this observation. Thus, if heirs of age join in a deed of quitclaim with a trustee of the ancestor's real estate, to complete title made by a previous deed executed by the trustee, it is said that they will thereafter be 'estopped' from contesting the validity of that earlier deed. So if a man assent with knowledge of the facts to the appropriation by an officer of the law of moneys arising from a judicial sale, he will be estopped thereafter from objecting.
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> The same careful writer says (p. 684), under the head of "Quasi-Estoppel," "Election," and a subhead, "Inconsistent Positions:" "Thus, a party actively affirming a transaction such as a contract or a purchase, by receiving and retaining

money upon it, is estopped thereafter to deny the force of any of its express or implied terms or conditions." He suggests there is no great objection to the use of the term "estoppel" in such cases if used as a synonym with "bar" or "preclusion" (p. 694).

Under the subheads of "Acceptance of Benefits" and "Quasi-Estoppel" (16 Cyc., *supra*), it is said: "Where one having the right to accept or reject a transaction takes and retains benefits thereunder, he becomes bound by the transaction and cannot avoid its obligation or effect by taking a position inconsistent therewith." But the custom is to include the doctrine just announced under the head of "estoppel" and so the case learning terms it. If it were to be held that one invoking the doctrine should know the fact of acceptance of the proceeds of a judicial sale and in reliance upon that acceptance, change his condition, the doctrine would have little application in the practical administration of justice. It is not the rule for purchasers at judicial sales to interest themselves in the distribution of the amount bid, in the first instance nose out the disposition of such funds and act on the strength of knowledge so obtained. It is sufficient that when their title is assailed they are able to show by way of defense that the assailant elected to affirm the transaction by accepting the fruits of the sale. A long line of cases in Missouri sustains that doctrine on grounds of elevated morals. In no case we can find, breaking on the exact point, was any stress laid upon the fact that the party invoking this particular form of estoppel need know at the outset of the act of affirmance or change his position on the strength of it in order to make it effective as a defense. In some of those cases other forms of estoppel were present and the discussion is broad enough to cover them, but in the precise form up for consideration the rule is as stated above.

The form of estoppel by the acceptance and retention of benefit, for which we are contending, as distinguished from a technical estoppel *in pais*, is illustrated in *Utermehle* v. *Norment*, 197 U. S., 40, when this court said:

> As to what is the law relating to a party taking the benefit of a provision in his favor under a will, there is really no foundation to dispute the proposition that he thereby is precluded from at the same time attacking the validity of the very instrument under which he received the benefit.

In *Hyde* v. *Baldwin*, 17 Pick. 303, 308, it was held that one who accepted the beneficial interest under a will was

thereby barred from setting up any claim which would defeat the full operation of the will. *Drake* v. *Wild,* 70 Vermont, 52, holds the same doctrine. In that case a party was held to be estopped from asserting her title to a trust fund disposed of by the will, because she had accepted the provisions of the will in her own favor. In *Branson* v. *Watkins,* 96 Georgia, 54, it was held that one who took an estate under a will was thereby estopped from at the same time denying its validity as a will, or from questioning the jurisdiction of the court admitting it to probate, or the regularity of the probate proceedings. In *Smith* v. *Smith,* 14 Gray, 532, it was held that the acceptance of a devise estops the devisee to set up a title in opposition to the will, at law as well as in equity. In *Fry* v. *Morrison,* 159 Illinois, 244, it was held that one who took a beneficial interest under a will was thereby estopped to set up any right or claim of his own, though otherwise well founded, which would bar or defeat the effort of any part of the will. And in *Madison* v. *Larmon,* 170 Illinois, 65, 82, it was again held that one who takes under a will cannot contest it as an heir at law of the devised property. So, in *Fisher* v. *Boyce,* 81 Maryland, 46, 53, the court said: "It is a maxim in a court of equity not to permit the same person to hold under and against a will. * * * It is equally appropriate to the jurisdiction and practice of courts of law. If the appellees claim under the will of their father, they must give it effect as far as they can, and they will then be estopped from denying its validity and genuineness. *Waters' Appeal,* 35 Pa. St. 523; *Thrower* v. *Wood,* 53 Georgia, 458."

In *Humes Construction Company* v. *Casualty Co.,* 32 R. I. 246, which was an action on a policy of employer's liability insurance, it was held that the Casualty Company, by taking charge of the defense of the suit brought by the employe, estopped itself to deny liability under the policy. It is pointed out that, however necessary a misrepresentation of fact may be as the basis of an estoppel *in pais,* it is not an "indispensable element" in the form of estoppel, which we contend is a complete bar to the assertion of the Trust Company's claim in this case. The court said:

> We are of the opinion, however, that, in exact legal terminology, the defendant by its conduct should be said to have estopped itself to deny liability under the policy rather than to have waived any right under the policy. Whether the action of the defendant be termed a "waiver," "estoppel," "quasi-estoppel," or "an election ripening unto an equitable estoppel," its liability is based upon the broad equitable prin-

ciple, which courts of law will recognize, that a person, with full knowledge of the facts, shall not be permitted to act in a manner inconsistent with his former position or conduct to the injury of another. This doctrine has been frequently applied in cases relating to employers' liability insurance.

The defendant's counsel has argued that the doctrine of estoppel cannot be applied in this case, because there does not appear by the allegations of the count to have been any *misrepresentation* or concealment of material facts on the part of the defendant, nor does it appear that the facts were not equally as well within the knowledge of the plaintiff as of the defendant. *These objections overlook the distinction between quasi-estoppel and estoppel by misrepresentation.* The term "quasi estoppel" has been applied to certain legal bars which are in some respects analogous to estoppel *in pais*, and which have the same practical operation as an estoppel *in pais*, but which nevertheless differ from that form of estoppel in essential particulars. The term includes the doctrine of election, the principle which precludes a party from asserting, to another's disadvantage, a right inconsistent with a position previously taken by him, and certain forms of waiver. 13 Cyc. 784.

In *Tozer* v. *Guarantee Corp.*, 94 Minn. 478, it is said:

No doubt appellant acted in good faith; but bad faith is not always necessary to estoppel, and it does not always follow that no estoppel will arise when the party to whom the representation is made has knowledge as to the truth of all the facts. Appellant comes within the rule that a person is precluded from taking, merely because his interests may change, a position inconsistent with one previously assumed by him, and to the prejudice of a third person. 1 Ency. Law, subd. 6, p. 46. We think the position of appellant in this case is analogous to that of a party who has taken advantage of an unconstitutional law to stay execution against him by putting up a bond. In such case it has been held that he would not be permitted to question its validity thereafter, notwithstanding that the law under which he was proceeding was afterwards declared unconstitutional. *Davis* v. *Wakelee*, 156 U. S., 680, 15 Sup. Ct. 555, 39 L. Ed. 578. In that case the following general statement was made: "It may be laid down as a general proposition that where a party assumes a certain position in a legal proceeding, and succeeds in maintaining that position, he may not thereafter, simply because his interests have changed, assume a contrary position, especially if it be to the prejudice of the party who has acqui-

esced in the position formerly taken by him." So, in this case, simply because it may be for its interest, appellant will not be permitted to change its position to the prejudice of the party who acquiesced in its line of conduct. By its own election appellant put the question of indemnity at rest.

In *Gaddes* v. *Pawtucket Institution*, 33 R. I. 177, it is said:

> Where a stranger to the title, or one having only a limited interest in a tract of land, conveys the property to another by deed or mortgage, and the owner receives the benefit of any part of the proceeds, knowing the facts, he is estopped to deny that the deed or mortgage conveys a good title. And likewise, if the owner, though *ignorant* of the facts when he receives the proceeds, *afterwards learns the truth*, his retention of the proceeds thereafter estops him from disputing the validity and effect of the conveyance. *Brewster* v. *Baker*, 16 Barb. (N. Y.) 613, 618; *Kahn* v. *Peter*, 104 Ala. 523, 16 South. 524; *Ansonia* v. *Cooper*, 66 Conn., 184, 33 Atl. 905; 16 Cyc., 787-791. See, also, *Brewer* v. *Nash*, 16 R. I., 458, 17 Atl., 857, 27 Am. St. Rep. 749; *Robinson* v *Bailey*, 19 R. I., 464, 36 Atl. 1126; *East Greenwich Inst. for Savings* v. *Kenyon*, 20 R. I., 110, 37 Atl. 632.

In *Field* v. *Doyon*, 64 Wis. 560, it is held if the mortgagee of personal property, with full knowledge that the same has been sold by the mortgagor for its full value, accepts the money realized from said sale and credits the amount on the mortgage debt, he is estopped from thereafter asserting any right to such property under the mortgage. The court said:

> The fact that the sale was made without his knowledge at the time does not change the relations of the parties when he admits that he was immediately informed of the sale and accepted the money received from the purchaser. He is estopped from asserting his title in either case. Bigelow on Estoppel (3rd Edition) 579, says: 'In like manner, if one *without actually inducing* another to act in a particular way assent to the thing done and seek to derive a benefit from it, he cannot, in case of disappointment, repudiate the validity of the act assented to.'

In *Grand Rapids Railway Co.* v. *Osborn*, 193 U. S. 17, it is held purchasers of a railroad not having any right to demand to be incorporated under the laws of a State, but voluntarily accepting the privileges and benefits of an incorporation law, are bound

by the provisions of existing laws regulating rates of fare and are, as well as the corporation formed, estopped from repudiating the burdens attached by the statute to the privilege of becoming an incorporation.

In *Chard* v. *Warren*, 122 N. C. 75, it is held that creditors who claim under a deed of trust and file their claims to share in the proceeds of sale cannot be heard to impeach its provisions. The court said, page 85:

> But beyond this, how can the creditor appellants who claim under this deed be heard to impeach it? They have filed their claims before the commissioners and have proved them. The security for their debts depends upon the provisions of the deed from Warren to Chard, and one who claims a right under a deed cannot be heard to impeach its provisions. *Fort* v. *Allen*, 110 N. C., 183. In Bigelow on Estoppel, 683, it is said: 'Upon a principle similar to that applied to persons taking under wills, beneficiaries under a trust are estopped by claiming under it to attack any of its provisions.'

In *Greeley* v. *Savings Bank*, 103 Mo., 212, it is held that where a creditor accepts a dividend at the hands of the receiver he will be estopped to deny the validity of his appointment. The court said, page 222:

> The exceptor having accepted the dividends made from time to time from the hands of the receiver, and having thus recognized the validity of his appointment during all that time, cannot now change front and deny the validity of that appointment. He is clearly estopped from so doing. Bigelow on Estoppel (5th Edition) 687.

In *St. Louis* v. *Davidson*, 102 Mo., 149, it appeared that the City had contracted the services of prisoners in its workhouse to a private person and that the contract was *ultra vires*, being neither authorized nor prohibited by the City charter, but that it was not illegal. It was held that the City was entitled to recover for the work actually done by the prisoners and not paid for and that the other party, after having derived benefits under the contract, was estopped from denying its validity. The court said:

> But upon a yet broader ground the defense (of *ultra vires*) set up in the answers cannot be maintained; the contract was not prohibited by law. The principal in that contract

has derived benefits under it; he cannot retain those benefits and repudiate the source from which they spring by denying the validity of the contract in which they originated. In short, *he is estopped to grasp the benefits of that contract with one eager hand, while thrusting aside its burdens with the other.*

The principle here asserted is one promotive of fair dealing which is the basis of estoppels and it is good law, as exemplified by many adjudications.

The court also quotes with approval the following from Bigelow on Estoppel, 5th Edition, 685:

Though a contract be in fact wholly invalid when executed, still (supposing it not to be prohibited by law as relating to some illegal transaction), if it be acted upon afterwards by the parties to it as valid, they will be estopped thereafter to allege its invalidity.

In *Robinson* v. *Pebworth*, 71 Ala., 240, the court said, page 247:

Estoppel in such cases is a reasonable doctrine, and simply means that *you shall not take the fruits of an illegal transaction and afterwards set aside the transaction as illegal.* In other words, that you shall not be heard to claim both *under* and *against* the same title.

We are invoking the rule—which is much broader than the rule of a technical estoppel *in pais*—that the acceptance and retention of benefits under a will, contract, plan of reorganization, or what not, operates as a complete estoppel or bar against any action or proceeding which does not recognize and give effect in its entirety to the transaction from which the benefits have been derived. Whatever name may be given to this rule, it is one firmly established in our jurisprudence. It is not dependent upon (a) the existence of a misrepresentation, (b), ignorance of the truth, or (c) action induced by the misrepresentation, or (d) injury if the truth is permitted to be proved.

The court of appeals, we respectfully submit, unduly and unwarrantedly narrowed all consideration of the broad question of estoppel to a technical estoppel *in pais*, and wholly ignored the broad principle that one may not accept and retain the benefits of a transaction and afterwards, with the fruits of the scheme still in his pockets, denounce the transaction as illegal, or *ultra vires*, or fraudulent, and base a cause of action thereupon.

IX.

The application to the facts in this case of the familiar rules that he who seeks equity must do equity, and must come into court with clean hands, is fatal to the contention of the Trust Company, even if it be assumed (as it is not) that the reorganization plan amounted to a fraudulent conveyance to stockholders of assets to which general creditors had a right to resort for the satisfaction of their claims.

It would be most repugnant to these equitable maxims, if the Trust Company were allowed to enforce its claim against the Southern Company, on the theory of the Boyd case, and yet retain in its treasury the securities which it received through the very transaction which, it is alleged, the Boyd case condemns as unlawful.

If the transaction was a fraud, the Trust Company participated in it to such an extent that it is entitled to no relief whatsoever under the plan, for the reason that it does not come into court with clean hands. It cannot make out a case of fraud in the diversion of assets from the reach of creditors of the Belt Company, without showing its own participation therein (*Harriman* v. *Northern Securities Company*, 197 U. S. 244, 295). It has no standing in a court of equity to cry fraud until it has purged itself of its own participation in the very scheme or device which it now seeks to assail. A few of the many cases which apply to the rule are cited below.

In *Randall* v. *Howard*, 2 Black, 585, the complainants and defendant had made an agreement to defeat the claims of third persons to certain lands which the complainants had mortgaged to the defendant to secure a debt, so as to cloak the ownership by means of a foreclosure sale at which the defendant should purchase and hold the nominal title. After obtaining the title, he fraudulently dispossessed the complainants and asserted the right of ownership in himself. The prayer of the bill was to restrain the defendant from disposing of the land, and to restore it, or so much of it as remained after paying the debt, to complainants.

The court, Mr. Justice Davis delivering the opinion, held that the agreement was a fraudulent one to defeat a claim set up by other parties for a portion of the mortgaged lands by covering up, through the aid of the court, the real ownership of the property, and said, p. 588:

> A fraudulent agreement was entered into to defeat, as is charged, a fraud attempted against the complainants. * * * A court of equity will not intervene to give relief to either party from the consequences of such an agreement. The maxim, *in pari delicto potior est conditio defendentis,* must prevail. It is against the policy of the law to enable either party in controversies between themselves, to enforce an agreement in fraud of the law, or which was made to injure another. Citing 1 Story's Equity, Sec. 298; *Bolt* v. *Rogers,* 3 Paige, 154; *Wilson* v. *Watts,* 9 Gill, 356.

In *Wheeler* v. *Sage,* 1 Wall., 518, an agreement was entered into between complainants and defendant to secure the title to valuable real estate of an insolvent debtor, at the expense and sacrifice of his creditors, which the defendant violated, and in conjunction with another person, secured an interest in the property to himself. The bill prayed that he be declared a trustee for the complainants, and be required to convey to them that portion of the land to which, under the agreement, they were entitled.

The court, Mr. Justice Davis delivering the opinion, said, p 529:

> Generally when a party obtains an advantage by fraud he is to be regarded as the trustee of the party defrauded and compelled to account. But if a party seeks relief in equity he must be able to show that on his part there has been honesty and fair dealing. If he has been engaged in an illegal business and been cheated equity will not help him. * * *
>
> A proceeding like this is against good conscience and good morals, and cannot receive the sanction of a court of equity. The principle is too plain to need a citation of authorities to confirm it. It is against the policy of the law to help either party in such controversies. The maxim, *in pari delicto,* etc., must prevail.

In *Dent* v. *Ferguson,* 132 U. S. 50, a person had conveyed his property to defendant for the purpose of defrauding his creditors. Subsequently the heirs of the grantor brought this bill to recover the property from the heirs of the grantee. Mr. Justice Lamar, delivering the opinion of the court, quoted both the above cases with approval, and said, p. 67:

> Such an agreement, so entirely inconsistent with the absolute conveyance of the property as executed between the parties, has all the features of a fraud upon creditors. It reserves

to the grantor the enjoyment of the rents and profits of the property conveyed, to which the creditors have a right of immediate appropriation to their debts, and involves a secret trust for the return to himself of property of which such creditors have the immediate right of sale. The law does not countenance any such transaction, but leaves both parties in the position where they have placed themselves. (*Lukins* v. *Aird*, 6 Wall, 78) * * * The prayer cannot be granted without overturning established principles of equity.

In *Bartle* v. *Coleman*, 4 Peters, 184, the syllabus is as follows:

Where parties were jointly interested in a contract with the government, and the agent for the government was secretly interested with them, and one part of their plan was to impose on its officers by false measures, the court refused to sustain a bill by one of the parties against another for an account.

Mr. Justice Baldwin, delivering the opinion of the court, says on p. 189:

The law leaves the parties to such a contract as it found them. If either has sustained a loss by the bad faith of a *particeps criminis*, it is but a just infliction for premeditated and deeply practiced fraud, which, when detected, deprives him of anticipated profits or subjects him to unexpected losses. He must not expect that a judicial tribunal will degrade itself by an exertion of its powers, by shifting the loss from the one to the other, or to equalize the benefits or burdens which may have resulted by the violation of every principle of morals and of law.

In *Schermerhorn* v. *de Chambrun*, 64 Fed., 195, the first paragraph of the syllabus reads:

C, who was engaged as agent of certain heirs of one J, in efforts to recover property formerly belonging to J, under an agreement for compensation contingent upon success, made a contract, in 1876, with defendant, a lawyer, for services. C made the agreed payments, and afterwards paid defendant other sums for further services. During the year 1876 C made contracts with sundry lawyers and other persons for services and advances, agreeing to pay them out of his share of the J property, after payment of expenses and counsel fees, making their claims liens upon such share. In August, 1880, C contracted in writing with defendant to pay him $30,000 in consideration of services rendered, the amount

to be a lien upon C's share of the J property. Defendant had rendered and continued to render important services throughout the litigation. After its close, resulting in a comparatively small recovery, C brought this suit to establish a trust for his benefit in the $30,000 which had been paid to defendant, alleging that the contract of August, 1880, was made upon a secret understanding between C and defendant that the $30,000 should be held in trust for C, in order to withdraw that amount from the liens of the contracts made in 1876, by making it appear to be paid as counsel fees. Defendant denied the existence of such trust. *Held,* that, assuming the alleged trust to be proved (as it did not appear to be), it would constitute a fraud upon C's creditors under the contracts of 1876, and a means of fraud upon others with whom he might contract, and equity would not aid C to obtain the fruits of such fraud from his co-conspirator.

To the same effect are:

Lawton v. *Estes* (Mass.), 45 N. E. 90, 57 Am. St. R. 450;

Deppen v. *German-American Title Co.* (Ky.), 70 S. W. 868;

Lemay v. *Bibeau,* 2 Minn., 291;

Scott v. *Edes,* 3 Minn., 388.

X.

The Trust Company is barred from a recovery in this action by its covenant that it would not hold the new company for the debts of any of the old ones.

The covenant is set forth in full in 210 Fed., 710, and the substance is given at page 712, as follows:

> No right is conferred, nor any trust, liability or obligation * * * is created by this agreement or the plan, or is assumed hereunder, or by or for any new company in favor of * * * any holder of any claims whatsoever against the said companies, * * * with respect to any property acquired by purchase at any foreclosure sale.

The master, in his report, finds that the Trust Company, in executing the covenant, thereby elected to accept the benefits of the reorganization rather than to take "its chances on the outside," and that in doing so it, in effect, agreed that it would not assert its

creditors' claim either against the committee or the Southern Company. He says (Rec. 861):

> The third section of the 12th paragraph of the reorganization agreement, provided that no right is conferred, nor any *trust, liability or obligation,* is created by or for a new company in favor of any claim whatever, against the companies involved, as to any matter or thing. The Trust Company executed said agreement as one of the depositaries thereunder and also accepted the benefits of its provisions when it exchanged the old securities it held against the constituent companies for the new securities of the Southern Company, and by so doing, *it has accepted and agreed to said provisions,* and cannot repudiate them, after receiving and enjoying the benefits thereof. In other words, the Trust Company might have refused to accept the benefits of the reorganization scheme and taken its chances on the outside, but it did not do so. *It has, in effect, agreed that it would not assert its creditors' claim either against the committee or the Southern Company,* for if it did so, it would thereby be asserting a claim which would be adverse to the reorganization plan and agreement, under which it had elected to take the benefits accruing to it as a depositor of its securities thereunder. It would seem, then, that under the circumstances above stated, *the Trust Company cannot now maintain an action against the Southern Company to enforce a right or trust in contravention of the terms of said agreement.*

The court, in assigning its reasons for denying the existence of any estoppel against the Trust Company, uses the following language, p. 711, of the second opinion:

> It may be that if, when the Trust Company signed the agreement, that instrument had disclosed a purpose or had by its terms required the committee, or the stockholders of the Belt Company, or their successory trustee, the new company, the Southern Company, to violate their trust and divert the equity of the creditors of the Belt Company in its property to its stockholders, the Trust Company's signature to it, its action as a depository of the bonds and stocks under it, and its exchange of its Belt Company stock for the Southern Company stock, might have wrought an estoppel against it.

All must concede that under the circumstances stated by the court the Trust Company would be estopped to maintain this action. It is pertinent to inquire *on what ground* or upon what principle the estoppel would exist in that case, for it may well be that

the same equitable principles which would apply in the case supposed would have equal application in the case under consideration. Obviously the ground or basis of estoppel in the case supposed would be:

(a) The fact that the Trust Company was a *party* to the agreement and hence the agreement was binding upon it; or

(b) The fact that the Trust Company had *accepted and retained benefits* under the agreement and was therefore estopped to question or deny its validity and binding force in all respects; or

(c) The fact that the Trust Company in accepting the new securities of the Southern Company in exchange for its old securities, thereby *consented* that the creditors' equity should be diverted from the creditors to the stockholders, and having thus consented and *participated in the distribution of the diverted equity,* was thereafter estopped from complaining that such diversion was a fraud upon the rights of the creditors.

What other ground of estoppel could there have been?

We confidently assert that all the grounds which would create an estoppel in the case supposed by the court are *equally applicable* in the case under consideration.

But the court undertakes to distinguish the supposed case from the case at bar by insisting that *the law must be read into the agreement,* and that the law created a *legal presumption* that the plan would be executed in a lawful way, which could only be done by offering or paying to the creditors of the Belt Company at least as much in value as the stockholders should receive. The court uses the following language in reaching this conclusion, p. 711:

> *But the agreement must be read in the light of the law which was necessarily a part of it.* It was to execute a plan, which it disclosed, to transfer the property of the Belt Company to a new company by means of the exchange of the stock of the new company for that of the Belt Company. The law was that as against creditors of the Belt Company such a plan could be lawfully executed in but one way, and that was by offering and, if accepted, by paying to the creditors of the Belt Company either in cash or in stock of the new company, or in some other property at least as much in value as the stockholders should receive, and, in the absence of such an offer or payment the transfer would be *fraudulent* and *voidable* as to the creditors. Unless there was in the agreement

some term or provision which required the committee or the Southern Company to violate this law and to make a transfer *fraudulent* and *voidable* as to the creditors, the *legal presumption* was that the agreement contemplated, and that the committee and the Southern Company would make, such an offer and payment to the creditors, and upon that presumption the Trust Company had the right to rely when it signed the agreement and thenceforth until it was clearly notified to the contrary. The legal presumption was that the committee and the new company, the Southern Company, which was to succeed to the trusteeship of the stockholders of the Belt Company, and all others executing the agreement would obey the law, would *refrain* from making the transfer of the property from the Belt Company *fraudulent* and *voidable*, and would make it fair, just, and valid. The Trust Company had the right to calculate the natural and probable result of its signature to the agreement and of all its acts and omissions in reliance upon this presumption. Indeed, it could reckon upon no other, for it is alike impracticable and impossible to predicate and administer the rights and remedies of men upon the theory that their associates and fellowmen will either violate the laws or disregard their duties.

It is, of course, true that the law must be read into the agreement. But this salutary rule means that *all* of the law applicable to the situation must be read into the agreement. It is not sufficient to read *one principle of law* into the agreement, as we believe the court has done, and to *exclude* others equally pertinent, and, as we think, *of paramount and controlling importance*.

The law of estoppel, or as it is sometimes called, *quasi* estoppel, the doctrine of equitable election, the rule of estoppel by acceptance and retention of benefits, *must all be read into the agreement*. They do not create mere legal presumptions subject to being defeated by some subsequent event or superior equity. They are absolute rules which fix, define and determine the rights and obligations of the parties.

If the law of estoppel had been actually written into the agreement, *as it was there in legal contemplation*, side by side with the "legal presumption" to which the court refers (assuming it to exist), then we should have had in the agreement a paragraph in substance as follows:

This reorganization is one in which stockholders are permitted to participate, and that implies a diversion of the equity

of creditors from them in favor of stockholders who possess an inferior equity. Such a plan carries the legal presumption that creditors, *who do not assent to the plan*, will be paid or settled with in some way, and if they are not paid or settled with, they retain the right to the satisfaction of their claims against the new company to the extent that the equity belonging to the creditors has been diverted from them and given to the stockholders.

But remember at all times that any unsecured creditors who *assent* to the plan, or *participate* therein, or receive any *benefits* therefrom, particularly if they be stockholders and as such *participate in the wrongful diversion of the creditors' equity*, are forever *barred and estopped* from claiming or alleging that the plan or agreement is unlawful, or that the diversion of the creditors' equity to stockholders is a breach of trust, or that the plan has operated as a fraud upon unsecured creditors.

The Trust Company signed the agreement with this warning which the law had plainly written into it. It can claim no benefit from the "legal presumption," to which the court refers, for the reason that such presumption, if it existed, had been overcome by the *paramount and controlling rules* which operated to estop the Trust Company from maintaining this action. The court says that the Trust Company had the right to rely upon this legal presumption "thenceforth until it was clearly notified to the contrary." *But it was clearly notified to the contrary the moment it signed the agreement.*

We insist that no such "legal presumption" existed, or could exist in favor of the Trust Company. There was no *obligation* to pay creditors, such as the Trust Company, who assented to the plan, and received benefits from it, and thus placed upon it the stamp of their approval. When there was no legal obligation to pay, there could be no legal presumption that payment would be made.

(a) The court of appeals proceeds upon the assumption that the plan carried the presumption that some fair offer would be made to creditors, and that the plan, therefore, was a valid and lawful plan until after the Trust Company had received its securities in July, 1900, and *then it became fraudulent and voidable only when the Trust Company's debt was not paid.* It is said that "the *fraud* and breach of trust, which made the transfer voidable as

to creditors, were not committed or disclosed until *after* the Trust Company's acts in the formation and execution of the plan had been done."

If the plan became fraudulent only after the Trust Company's debt was not paid, as the court of appeals decided, nevertheless the Trust Company's retention of the fruits of the scheme is a conclusive bar to a recovery. We do not by any means concede the correctness of either the premises or the conclusion of the court. On the contrary, we contend that both are erroneous, and we contend furthermore that the premises assumed by the court lead to an entirely different conclusion from that reached by it.

Let it be assumed that the law, which prescribes the order of distribution of the assets of insolvent corporations, be read into the plan, and that the Trust Company when it signed the agreement had a right, until notified to the contrary, to rely upon the presumption that some offer would be made to creditors, and that the plan operated as a *fraud* and breach of trust only *after* the Trust Company's acts in the formation and execution of the plan had been done. The very facts assumed, in their last analysis, present a situation, innocent in its inception, which subsequently developed into a typical case of *fraudulent conveyance.* The benefits which the Trust Company has received and still retains are subsequently, if not at the outset, the *fruits of a fraudulent transaction.* The Trust Company therefore is in the attitude of a complainant who comes into a court of equity with the tainted proceeds of a fraudulent scheme still in its treasury, which it confesses by its pleadings *ought not to be there,* and bases its claim for relief upon the same illegal transaction from which it has profited. Does not this attitude of the Trust Company—to borrow an expression from the Monon case—come within "judicial denunciation?"

In *Kahn* v. *Peter,* 104 Ala. 523, it appeared that the complainant, Kahn, and one Werborn, were liable as sureties on a defaulted bond and to defeat the collection thereof, Werborn transferred his property to a creditor in payment of a debt and in consideration of the latter's agreement to pay certain of the former's debts, including that due the complainant, which agreement was performed. Complainant subsequently paid the judg-

ment rendered on said bond and afterwards filed his bill in equity to set aside the transfer of Werborn's property, claiming the right of subrogation to the rights of a judgment creditor. It was held that having advised the transfer and retained the benefits under it, complainant could not attack it though he *did not know* at the time he advised it or when he received the benefits that the transferee's claim was fictitious. The court said:

> But it is said this doctrine should not be applied to the complainant, because when he advised the sale to Charles Werborn, and when he accepted payments of his claim from Charles Werborn according to the terms of the sale, he did not know, what he now asserts, that Charles Werborn's debt, upon consideration of which in part the sale was made, was simulated. There is nothing in this contention. In the first place, the sale was made *upon his consent and advice* as an interested party; and this advice and consent, which the evidence shows contributed materially to the consummation of the sale, should not have been given ignorantly. So that, whether cognizant or not of the now alleged fictitious character of Charles Werborn's claim against Geroge, he was at fault in advising, and thus bringing about, the sale, and he cannot now be permitted to undo what he then accomplished. His position and rights in this connection are not unlike those of the seller himself. *And, further, leaving the fact of his having advised the sale out of view, whether the sale as to Charles was fraudulent or not, and whether, it being conceded to be fraudulent, he had knowledge of the fraud when he claimed and received benefits under it, or not, he cannot, while retaining those benefits—while holding onto the money which he received from Charles in consideration of the sale—have the transaction avoided.* This would be the taking and holding *under* and claiming *against* the conveyance which all authorities denounce. And there is no pretense that he has surrendered or is willing to surrender, what he received. He is even *now*, with full knowledge of the alleged fraud, claiming both *under* and *against* the bill of sale.

In *Brewer* v. *Nash*, 16 R. I. 458, it is held:

> Where mortgagors receive the surplus proceeds of a sale made under a power, in ignorance of defects invalidating the sale, but *afterwards* acquire knowledge of such defects, and continue to *retain* the proceeds, they are estopped from denying the purchaser's title.

(b). *The plan could not become fraudulent by events subsequently transpiring.* It is conceded by the court of appeals that the plan and the proceedings under it were valid and free from fraud in July, 1900, at the time the Trust Company exchanged its securities. If valid at that time it could not become fraudulent by any subsequent acts of the committee or of the Southern Company. The subsequent action of the committee in declining to pay the Trust Company the amount of its indebtedness from the Belt Company could not have any *retroactive* effect to invalidate a transaction which was free from fraud at the time of its inception.

The rule on this subject is stated in 20 Cyc., page 413, as follows:

> A conveyance, to be fraudulent and void as against creditors, must have itself been fraudulent *when made*, and if it was not, then it cannot be rendered so by a fraudulent intent existing either before or after that time, or by the prior or subsequent conduct of the parties, or by other separate and distinct transactions, prior or subsequent, which were fraudulent.

In *Kreuger* v. *Vorhauer*, 164 Mo., 156, it is held:

> Schemes to defraud his existing and subsequent creditors, entered into by a party after making the deed of trust, cannot affect the validity of such deed.

(c) *It is confidently asserted that if the reorganization plan was ever fraudulent and voidable as to creditors, it was so at the time of its execution by the Trust Company and that the covenant is a complete bar.* It is a new doctrine that before the plan is subject to criticism, it must *affirmatively* show upon its face that creditors will *not* be paid. On the contrary, in the reorganization agreement in the Boyd case, which the majority opinion holds to be fraudulent as to "non-assenting creditors," it is said:

> The agreement contained *no provision* as to the payment of unsecured creditors.

And also:

> The invalidity of the sale flowed from the *reorganization agreement.*

The same is true of the plan in the *Monon case*, 174 U. S., 674, and in the Howard case, 7 Wall., 392.

The *covenant* in the twelfth paragraph, to which the Trust Company assented, was a distinct and unequivocal *caveat* that no claims against the old company could be enforced against the new company. How can the *covenant* and the *presumption*, in which the court of appeals indulges, co-exist in the same instrument, since the covenant *excludes* any such presumption?

No presumption could arise to contradict the plain meaning of the plan, which was that $475,000, and no more, was set aside to pay the floating debt, which meant such debt as it was necessary to pay in order to make the mortgage of the new company a first lien (Rec., 860, 861). How can this provision be said to raise a presumption that *all* the floating debt of *all* the companies was assumed by the committee or the Southern Company?

(d) *There could be no presumption that the floating debt would be paid, on which the Trust Company could rely to escape the effect of the covenant, for the Trust Company must have known that no such thing was possible.* Certainly that no such thing was contemplated by the plan. The reorganization agreement disclosed on its face the specific appropriation to be made of *all* the securities and of *all* of the funds of the new company. Its bonds and stocks were to be used (1) in exchange for old securities, (2) for future requirements of the company which included future additions, betterments, and new equipment (Rec., 820), and (3) for specific cash requirements of the company, (Rec., 820, 821). The available assets of the new company are all accounted for, the sum of $475,000 being set aside for the payment of the floating debts of *all* of the constituent companies (Rec., 820). The floating indebtedness of the Belt Company *alone*, which represented only 3⅓ per cent in value of the companies included in the reorganization, as above stated, was $900,000 (Rec., 755).

The Trust Company knew this because it knew the financial condition of the Belt Company. All of the officers and directors of the Belt Company, except one, were officers, directors, or employes of the Trust Company (Rec., 756). "The inter-relations of the Belt Company and Trust Company were exceedingly intimate" (Rec., 760), and the Trust Company kept the books of the Belt Company.

It is a violent and wholly unwarranted presumption to assume that the plan contemplated the payment of the floating debt of *all* of the companies when but $475,000 was set aside for that purpose, and the floating debt of *one* company alone was *twice* that amount, as the Trust Company must have known.

(e) *The covenant bars a recovery, whether the reorganization plan was fraudulent as to non-assenting creditors at the time the Trust Company became a party to it, or only became so afterwards when the Trust Company's debt against the Belt Company was not paid.* Whenever the plan, or action taken under the plan, became fraudulent as to creditors, the duty *immediately* devolved upon the Trust Company to *elect* whether to accept the benefits of the fraudulent scheme, or to *retain* them if they had already been received. The duty to tender back the fruits of an illegal and fraudulent transaction upon a discovery of the fraud is an imperative duty, and is an indispensable condition to the maintenance of any action based upon the fraud. The equitable rule of estoppel, or election, or ratification, becomes at once applicable. *A retention of the fruits of the fraud is a conclusive election to hold under the plan and is an insurmountable barrier to any attack upon the plan.* (*Stone* v. *Cook*, 179 Mo., 534; Vol. 11 Am. & Eng. Enc. of L. [2nd Ed.] p. 98; *Young* v. *Young*, 27 Atl. Rep., 627; *Medill* v. *Snyder*, 58 Pac. Rep., 962).

(f) *Assuming that the foreclosure and sale of the Belt property was brought about by the plan (which is not admitted) it necessarily follows that the liability of the Southern Company, if any, was created by the plan and is barred by the covenant.* It is respectfully submitted that if any liability could, under any circumstances, exist against the Southern Company, it must necessarily be a liability *created by the reorganization plan or agreement* and as such barred by the covenant since, as said in the Boyd case, "the invalidity of the sale flowed from the *agreement*." The bar of the covenant cannot be escaped by the assertion that the liability was created, not by the agreement, but by the transfer of the Belt property. The foreclosure cannot be divorced from the *agreement* if they are to be regarded as part and parcel of the same transaction. The court of appeals itself recognizes this fact when it says (210 Fed., 703):

For what purpose then was the foreclosure? Evidently to *carry out* the reorganization agreement.

(p. 703). *Was not the scheme of reorganization* the *primary cause,* the *vesting of the fee* of the Belt Property in the Southern Company by the foreclosure, the *object and effect* of that scheme, and the exchange of the stock and the foreclosure of the Belt mortgage the *means* contemplated and authorized by that scheme to attain that end? To the minds of the members of this court the record in this case leaves no alternative but to answer these questions in the affirmative.

(p. 704). By virtue of the *plan of reorganization,* the Southern Company had become such trustee (for unsecured creditors.)

(p. 704). They (the acquisition of the property of the Gulf Company and later of the Belt Company) appear to this court to constitute a single transaction instituted, conducted, and consummated *pursuant to the preconceived plan to vest the fee of the properties of the Belt Company in the Southern Company* and to bring them directly under the lien of its mortgage.

It is not consistent to say that the Southern Company's liability "was not created by that agreement, but by the Southern Company's subsequent transfer of the equity of the creditors of the Belt Company to itself, its stockholder, and trustee for its creditors, without securing and paying to them the value of that equity."

A transfer of the equity of the creditors of the Belt Company, in the opinion of the court of appeals, as appears from the foregoing excerpts, was solely in pursuance of the reorganization agreement and would not and could not have occurred *but for the agreement.* The agreement, the court says in the above quotations, was the "primary cause," the foreclosure sale the "object and effect" of the scheme, and the exchange of stock the "means" employed. Therefore, it seems plain that if, as the court of appeals decides, a liability was created on the part of the Southern Company by the exchange of stocks (which was the "transfer of the equity of creditors of the Belt Company"), such liability was *created* by the reorganization agreement, and it necessarily follows that the assertion of such liability is effectively barred by the covenant. If the agreement and the foreclosure are *not* to be regarded as part and parcel of the same transaction, but are to be separated and viewed as independent transactions, then the rule of the Boyd

case has no application, and there is no necessity to resort to the covenant.

(g) Furthermore, the court of appeals says, (210 Fed., 712), that if any equity or trust were created or conferred by or under the reorganization agreement, they were conferred, not by the just and lawful execution of the ageement, but "by an inequitable and fraudulent appropriation of the Trust Company's equity in the property to the benefit of its stockholder or stockholders." But it was the *exchange of stocks*, to which the Trust Company was a party, which created the so-called "inequitable and fraudulent appropriation of the Trust Company's equity in the property" and the exchange of stocks was brought about by the plan and was the direct result of the plan. The exchange of stocks was only a *means*, as the court of appeals itself says in the above quoted excerpt, of carrying out the reorganization plan. It could not have taken place but for the plan. If the exchange of stocks resulted in the fraudulent diversion of assets to stockholders, then the covenant obviously operated to bar the assertion or enforcement of such right.

The obvious intent of the covenant, without the necessity of resorting to any refinement of reasoning, was to make it clear to all depositing security holders that if they took the benefits of the plan they thereby waived the assertion of any and all rights, liabilities, trusts, or obligations against the new company arising out of any dealings with the old companies or any of them.

XI.

The acquisition by the Southern Company of the stocks and bonds of the Belt Company, by exchanging the former for the latter in certain specified proportions under the plan, was lawful, being expressly authorized by the Missouri statutes. The reorganization plan had spent its force when the Southern Company on April 1, 1900, came into possession of the property of the Gulf Company acquired at foreclosure sale, as well as the stocks and bonds of the Belt Company. The subsequent foreclosure of the Belt Company, (which destroyed all stockholders' interests in that company), was not brought about by the reorganization committee, or by the reorganization plan, but by the independent action of the Southern Company as the owner of a large majority of the bonds of the Belt Company, in causing the foreclosure of a mortgage securing the bonds which were then in default, and of this no creditor of the Belt Company can complain.

On April 1, 1900, the Southern Company was the owner, by purchase at foreclosure sale, and engaged in the operation of the railroad formerly owned by the Gulf Company. It was also the owner of a large majority of the stocks and bonds of the Belt Company, and it was engaged in operating the property of the Belt Company indirectly through the officers of the Belt Company, who were its nominees. The exclusive control of the Southern Company was vested by statute (Sec. 2992, R. S. 1909) in its board of directors, and, likewise, the exclusive control of the Belt Company was vested by law in its officers and directors.

It is our contention that at this time the reorganization had been accomplished and the plan had spent its force; and that the subsequent foreclosure and sale of the property of the Belt Company, which is alleged to have created a liability on the part of the Southern Company for the unsecured debts of the Belt Company, was not due to the reorganization plan, but was the result of the independent action on the part of the officers and directors of the Southern Company as the owner of the bonds of the Belt Company then in default.

It cannot be successfully maintained that there was anything unlawful or fraudulent in the acquisition by the reorganization committee, or by the Southern Company, of the stocks and bonds

of the Belt Company, either under the plan of reorganization, or otherwise. The lines of the two companies formed a continuous line by direct connection. Such acquisition was in pursuance of express statutory power given by Section 3080, R. S. Mo., 1909, which authorized the Southern Company to,

> Acquire any line of railroad within or without this state which shall form a continuous line with the road operated by such company by direct connection * * * *and may acquire and hold the obligations and stock of other companies owning or operating any such lines of road.*

If the reorganization committee, or the Southern Company, had purchased the stocks and bonds of the Belt Company by making a cash payment therefor, as they did purchase the stocks of the Union Terminal and Air Line by the payment of cash, then it must necessarily be conceded that such a purchase would have come within the express permission of the statute. But the exchange of stocks and bonds was in effect a purchase and sale within the rule of *Harriman* v. *Northern Securities Company*, 197 U. S., 244.

If the Southern Company, after becoming the owner of the property of the Gulf Company and of the stocks and bonds of the Belt Company on April 1, 1900, had continued in the operation and management of the Gulf property acquired at foreclosure sale, and had continued to own the stocks and bonds of the Belt Company, without causing any action to be instituted for the foreclosure of the mortgage securing the bonds, for a period of, say five, ten or twenty years, no one would contend that such a transaction was unlawful, irregular, or even unusual.

Pullman Company v. *Railway Company*, 115 U. S., 587;
Peterson v. *Railway Company*, 205 U. S., 364;
Atchison Company v. *Cochran*, 43 Kans., 225;
Stone v. *Railway Company*, 202 N. Y., 352.

If upon the expiration of any one of the periods supposed, the Belt Company had made default in the payment of interest upon the bonds held by the Southern Company, and the trustee in the mortgage of the Belt Company, as required by the terms of the mortgage in such contingency, had caused the property to be foreclosed and sold, no stockholders' interest being preserved to

the Southern Company, no creditor of the Belt Company could have complained, and no one would have imagined that there was any fraudulent conveyance to defeat the claims of creditors.

An apt illustration is found in *Pullman Car Company* v. *Missouri Pacific,* 115 U. S., 587. There the Missouri Pacific Railway Company issued its stock in exchange for the stock of the Iron Mountain Company, and in that way became the owner of all but 1,195 out of 220,682 shares of the capital stock of the Iron Mountain Company. The Missouri Pacific Company has continued to own the capital stock of the Iron Mountain. If the Iron Mountain should default in the payment of interest on its bonded indebtedness, would anyone claim that the Missouri Pacific, in case it should purchase the property at foreclosure sale, no stock interest in the Iron Mountain being preserved, would thereby assume the floating debt of the Iron Mountain? Certainly not. The obvious reason is, giving to the Boyd case and the Monon case the far reaching effect claimed for them, that the original acquisition by the Missouri Pacific of the capital stock of the Iron Mountain was a lawful act expressly authorized by statute; that no creditor of the Iron Mountain was injured thereby, all of his rights against its debtor and its debtor's property being precisely the same after the transaction as they were before; and that the foreclosure proceeding was the result of the default in the payment of interest upon the mortgage indebtedness, and was not the result of the plan for the exchange of capital stock.

How can it be said in the case at bar, that the creditors of the Belt Company were injured because the reorganization committee and the Southern Company acquired the stock of the Belt Company by the exchange of shares, which was brought about by the plan? *Their remedies against the Belt Company and against its property were precisely the same after the transaction as they had been before.* So far, no creditor had been injured or been affected injuriously or otherwise. How can it be said that the foreclosure of the Belt Company was the *direct result of the reorganization plan,* or that it was brought about by the plan, and *not* the result of action by the holder of the bonds of the Belt Company, *wholly independent of the plan?*

It cannot be said that the reorganization plan *required* the foreclosure of the mortgage of the Belt Company. It did not even

require that the terminals at Port Arthur and Kansas City should be brought into the reorganization; on the contrary, they might or might not be included, as appears by the following language:

> (f) Or in the event that either or both of said terminal properties are not so acquired, then (under arrangements already provided) the requisite terminal facilities at Kansas City and on the gulf will be otherwise secured—in which event, the amount of the new securities to be issued will, of course, be correspondingly reduced.

It is manifestly the fair intendment of that provision that if sufficient of the securities of the terminal properties should be deposited to "warrant the retention of that property by the new company," then the plan contemplated that the terminal properties, together with the Gulf properties, should be operated in the same interests, and thereby, in the language of the plan, *which was subject to modification in the discretion of the committee*, "all three properties will be under one corporate ownership, management and control," which might be accomplished by *stock ownership*, and was in fact accomplished by the Southern Company's ownership of the stock of the Belt Company, Canal & Dock Company, and of other allied companies. The plan did not *require* anything beyond this.

It was recited in the plan that "it is *intended* as soon as practicable, that the new company acquire the properties of the terminal companies in fee and bring them directly under the lien of the mortgage," and this expression of *intention*—which was the intention of the reorganization committee, and the Southern Company was free to accept or reject it in the exercise of its discretion—is seized upon by the court of appeals (210 Fed., 703, 704) as a justification for its conclusion that the foreclosure and sale of the property of the Belt Company was brought about by the plan of reorganization, and that it was one of the objects that the committee and the Southern Company were empowered and expected to carry into effect.

The plan was not a *contract* that this would be done by the committee or by the Southern Company. No *obligation* was imposed on the Southern Company to acquire the properties of the terminal companies in fee. It could do so, by enforcing its mortgage security, if in the exercise of its discretion it deemed that

course the wise one, and none of its security holders could object. *It could likewise have continued to hold the stocks and bonds of the Belt Company without a foreclosure, and no one could object.*

Suppose that some holder of securities of the Southern Company, who was a party to the plan of reorganization, should bring suit demanding that the Canal & Dock Company property (the stock of which, but *not* the fee, is held by the Southern Company) should be acquired in fee and brought directly under the lien of the mortgage, claiming that in the plan the "intention" was expressed that this would be done, and asking the court to require that this intention be carried into effect. No one would contend that such a suit would have the slightest hope of success. Any court, it is submitted, would say that the "intention" of the committee was not binding upon the Southern Company, and that it was for that company to decide for itself in the exercise of its discretion, in the event of a default under the mortgage, whether it would enforce the security or waive the default, and likewise in the event of a foreclosure sale whether it would or would not become the purchaser; and that the plan of reorganization was completely executed when the Southern Company became the owner of the stocks and bonds of the Belt Company and other allied companies, and also the owner and engaged in the operation of the property of the Gulf Company.

Could not the directors of the Southern Company at any time between April 1, 1900, and November, 1901, the date of the foreclosure decree, have resolved that the Southern Company, as the owner of a majority of the bonds of the Belt Company, would waive the default and that no foreclosure suit should be brought, or if one had been brought, that it should be dismissed? No one will contend that the Southern Company could have been *compelled* by process of law, to insist on the default, to proceed with the foreclosure, and to purchase the property at the foreclosure sale, or to respond in damages for a failure so to do, for the obvious reason that there was no legal duty or obligation so to do. No one can successfully contend that the Southern Company could not exercise every right that any other owner of stocks and bonds of a subsidiary company might exercise.

A complete settlement was made between the reorganization committee and the Southern Company in October 1900, and the

committee thereupon became dissolved. Its influence upon the affairs of the Southern Company could not have extended beyond that period, in the absence of some contract or obligation resting on the Southern Company, and that no such contract or obligation existed is one of the established facts in the case.

As the Southern Company was in exclusive control of the situation, after April 1st, 1900, it follows that the foreclosure and sale of the property was not brought about by the plan, but was wholly independent of it. In other words, (a) the purchase by the Southern Company at foreclosure sale of the property of the Gulf Company, and its acquisition of the stocks and bonds of the Belt Company, and (b) the foreclosure and sale of the property of the Belt Company following a default, were not one entire transaction.

The transaction may be analyzed as consisting of three separate and distinct steps or stages. There was, *first*, the exchange of the stocks and bonds under the plan by which the stockholders of the Belt Company became stockholders in the Southern Company, and when this was accomplished the plan had spent its force; *secondly*, the intervention of the Southern Company, as an independent agency, which assumed control, and excluded the reorganization committee from control; and, *thirdly*, the default in the payment of interest on the mortgage of the Belt Company, and the subsequent foreclosure of the mortgage with every stockholder's interest destroyed. It is submitted that there was nothing unlawful in these three steps, and that there was nothing in any of them of which any creditor can complain.

If six *years* had elapsed between the assumption of control by the Southern Company and the foreclosure of the mortgage of the Belt Company, no one would have said that the two transactions should be combined for the purposes of this suit. Is not the principle the same when but *six months* elapsed, instead of six years?

XII.

The mortgage indebtedness of the Belt Company was $1,000,000. It was sold at foreclosure sale for $1,000,000, which the master found was the fair market value at that time. Under these circumstances, the Trust Company, as a creditor of the Belt Company, has not been injured and has no right to complain.

(a) The findings of the master in respect to the value of the Belt property at the time of the foreclosure sale, which was more than a year after the exchange of stocks had taken place, will be found in the record (pp. 852-853). In substance, the master found that there was no *direct* testimony showing the value of the properties involved in the reorganization plan at the time of or prior to the foreclosure of the mortgage liens thereon; that there had been introduced considerable testimony tending to show that all the roads forming the Belt system were extravagantly built and were bonded largely in excess of their actual cost; that the considerations paid at the foreclosure sales were large and sufficient, being approximately the full amount of the bonded indebtedness upon the railroads foreclosed; that there was no proof in the record to show that the Belt properties sold under the mortgage foreclosure were worth anything *in excess* of what they brought at the sale, and, in the absence of such proof, the master specifically found that the amount for which they were respectively sold was their *fair market value at that time;* and that there was nothing in the record to show that the reorganization scheme in any way deprived the unsecured creditors of any rights they would otherwise have had, in case such scheme had never been consummated.

It is conceded that the mortgage indebtedness of the Belt Company was $1,000,000, and that it was sold at foreclosure sale for that amount.

There was no *direct* testimony of the value of the Belt property. No witness, qualified as an expert, gave his opinion as to the value of the property as an entirety. Such testimony would have been of little value, since railroad property is ordinarily valued (*Smythe* v. *Ames*, 169 U. S., 466, 547, Minnesota Rate Case, 230 U. S., 352), by ascertaining (a) the cost of construction, (b) the cost of reproduction, (c) the market value of outstanding stocks and bonds, and (d) the value reached by capitalizing the net earnings.

It is apparent from the record that the master had before him ample evidence upon *all* of these questions, although such evidence is not here to be reviewed. At page 852, the master says:

> There has been produced in this cause considerable testimony tending to show that *all the roads forming the Belt system were extravagantly built and were bonded in excess of the actual cost.*

Here was evidence as to the *cost of the road,* which, in view of its newness, would be approximately the cost of its reproduction.

It is apparent that the master had before him a very large amount of testimony as to the *market value of the stocks and bonds* of the Belt Company since that question was involved in the accounting feature of the case. (Rec., 694-721.)

There was also ample testimony before the master as to the financial operations of the Belt Company and its *net earnings,* if any, since one of the issues in the accounting case was whether the Trust Company did not cause the Belt Company, while insolvent, to pay dividends in 1893, 1894 and 1897. (Rec., 722.)

It is submitted, therefore, that the record affirmatively shows that there was testimony before the master as to *all* the bases for fixing the value of railroad property, and with this evidence before him, the master finds (Rec., 852), in speaking of the amount bid at the foreclosure sales of the property of the Belt Company and its allied company, that:

> The considerations paid for such properties were *large and sufficient,* being approximately the *full amount of the bonded indebtedness* upon each railroad foreclosed.

It is evident that the master's finding that the prices paid at the foreclosure sales were ample was not merely based on the amount for which the properties were sold, *but upon the testimony in the record directed to the recognized elements for valuing railroad property.*

The master finds (Rec., 853):

> 5. If respondent's contention is correct to the effect that there was a consolidation, *de facto,* by which the intervenor became liable for the Belt indebtedness, still there is no proof in the record to show that the Belt properties, sold

> under the mortgage foreclosures, were worth anything in excess of what they brought at the sale; and in the absence of such proofs, *the master finds that the amount, for which they were respectively sold, was and is their fair market value at that time.*

The master was doubtful whether the properties were worth as *much* as the amount of the bonded indebtedness. There was considerable testimony, as he states, that they were worth *less* than their bonded indebtedness. There was no testimony that they were worth *more.* In order to be on the safe side, and *giving to the Trust Company the benefit of any doubt,* he finds that the fair market value of the Belt property was the amount for which it sold at foreclosure sale, to-wit,—$1,000,000.

The master undoubtedly had in mind the rule that the stockholders should not preserve an interest in the property to which the creditors had a prior right, *and it was, therefore, his purpose to ascertain, as a question of fact, if any value of Belt property was being diverted from its unsecured creditors.*

This is apparent because he says (Rec., 853):

> It was competent for the bondholders, in furtherance of their own business interests, to use the stocks and bonds of the new company as they saw fit, *provided that it is not shown that in so doing it was a part of their scheme to give something of value to the stockholders that should have gone to the creditors.*

The master was also obviously anxious to ascertain if the reorganization plan had operated to the detriment or disadvantage of any of the unsecured creditors of the Belt Company, and his conclusion was that it had *not.* This is apparent from his finding (Rec., 853):

> It is not shown in the record that the reorganization scheme *in any way* deprived the unsecured creditors of any rights they would otherwise have had *in case such scheme had never been consummated.*

It should be constantly borne in mind that *no exceptions* were taken by the Trust Company to these findings of the master, and that such findings were based upon testimony which was not brought to the court of appeals. It is also to be borne in mind that the valuation made by the master in this "adversary proceed-

ing," as that expression is used in the Boyd case, was *at the time of the foreclosure sale of the Belt properties*, which was nearly *two years* after the foreclosure of the Gulf property and more than *one year* after the distribution of the securities of the Southern had taken place. Whatever increased value could arise from the *reorganized system*, as distinguished from the aggregate value of all the roads as separate units, had already taken place. The Trust Company had had an opportunity to litigate and had litigated in this action, the value of the Belt property at the time of the foreclosure sale, and the master's finding, to which no exception was taken, should, therefore, be taken as coming within the rule stated in the *Boyd* case, as follows:

> In saying that there was nothing for unsecured creditors, the argument assumes the very fact which the law contemplated was to be tested by *adversary proceedings*, in which it would have been to the interest of the stockholders to interpose every valid defense.

(b) If mortgaged property is sold for the amount of the mortgage, which is its *fair market value*, how can creditors be injured, and what ground is there for complaint, whether the sale be the result of a reorganization plan or not? In such a case, what difference does it make whether the former stockholders of the company, whose stock is practically valueless because the property is mortgaged to its full value, receive stock in the new company, which represents practically no value or interest in the mortgaged property for the same reason? If the Belt Company had conveyed its property to the Southern Company in consideration of the cancellation of its mortgage and without foreclosure, the result would have been the same.

The enforcement of the mortgage of the Belt Company left nothing available to general creditors. It is true that the stockholders of the Belt Company received stock of the Southern Company which had a value, but that value arose from the fact that it represented property of *other companies than the Belt Company* and the right to participate in the prospective earnings of such other companies.

Surely a reorganization cannot be said to *create* rights in favor of creditors which did not exist before, or to give value to a creditor's claim which was *valueless* before. The claim of the

Trust Company, even after the consummation of the reorganization plan and at the time of the foreclosure sale of the Belt property, was *without commercial value* for the reason that it was against a company whose assets were charged with a lien to secure an indebtedness which exactly equalled the fair market value of the property.

After the foreclosure a startling transformation has taken place since, according to the court of appeals, the claim is then worth dollar for dollar, simply because the mortgagee has foreclosed his lien, which is conceded to be a valid one, and the property has been sold for its fair market value, which is the exact amount of the mortgage indebtedness.

The purpose of the law against fraudulent conveyances is to *preserve* the rights of a creditor against the debtor's property, but the effect of the decision of the court of appeals in this case is not to preserve a right which existed, but to *create* a right where none existed before.

Where is the *equity* in the Belt property which warrants the court of appeals in imposing upon the Southern Company a judgment for $800,000? This judgment, to be valid, must represent an equity in the Belt property which the old stockholders of the Belt Company preserved for themselves, but the record demonstrates that no such equity existed.

(c) It is respectfully submitted that the court of appeals is in error when it says (210 Fed., 706):

> But the crucial issue here was not what the fair market value of the property was, nor was it how much more the mortgaged property was worth than the amount of the mortgage.

It is our contention that this, in a case based on the Boyd decision, is not only the crucial issue, but the *whole issue*. If it be once established in an adversary proceeding that the fair market value of a property, which has already become a part and parcel of a reorganized system against which stocks and bonds have already been issued, does not exceed the amount of its valid mortgage indebtedness, then no equity to which creditors are entitled to resort has been diverted to stockholders, *and it makes no difference what stocks or bonds have been previously issued by the reorganized*

system. As a stream cannot rise higher than its source, so the mere issue of securities cannot add to the *actual value* of property.

The court of appeals says (210 Fed., 706), that the real issue was:

> What was the equitable interest of the creditors in the mortgaged property of the Belt Company worth during the execution of the scheme and immediately after the foreclosure sale?

What equitable interest available to creditors could there have been, if it be conceded that the fair market value of the Belt property at the time of the foreclosure sale did not exceed the mortgage indebtedness? The court of appeals quotes from the Boyd case to the effect that:

> If the *value* of the road justified the issuance of stock in exchange for old shares, the creditors were entitled to the benefit of that value whether it was present or prospective, for dividends or only for purposes of control.

Concede this and yet the question reverts to "the value of the road." The issuance of stock cannot *create* value. The value of the stock depends upon the *value of the road.* The value of the road is not dependent upon the amount or par value of stock issued.

(d) We submit that the real issue is tersely and accurately stated by the Court of Appeals for the Sixth Circuit in *Wenger* v. *Railroad Company,* 114 Fed., 34, as follows:

> To the extent that the property is worth something more than the mortgages the general creditors are interested in any subsequent distribution, but beyond that their interest does not extend.
>
> The sole question is: had the railway property, as it existed at the time of foreclosure, a greater value than the mortgage indebtedness? And that such value existed is not averred.

The court in the Monon case, 103 Fed., 130, in speaking of the rights of creditors, said:

> What are their rights? Manifestly to have any surplus of value in the property or in its proceeds over and above the mortgage debts applied to the payment of their demands.

The *Boyd* case is not in conflict with this contention. In that case, there had been no "adversary proceedings" to determine the value of the property as there has been in this case. There, there was a "distinct recital" in the plan itself that the property to be purchased was agreed to be "of the full value of $345,000,000." This was an admission by the company itself and *prima facie* established the value. The strong intimation in the opinion is that if there had been an adjudication, binding upon the claimant, that the fair value of the property did not exceed its mortgage indebtedness, and that it had been sold at forced sale for the full value, there would have been no equity on which the claims of creditors could operate, and hence there could be no recovery by an unsecured creditor. In fact, the court says:

> If their (the old stockholders') stock is worthless, he (the creditor) gets nothing.

(e) But the court of appeals points to the fact that the old stockholders of the Belt Company received $1,187,500 of the preferred stock and $3,562,500 par value of the common stock of the *Southern Company* in exchange for the stock of the Belt Company, and by a process of reasoning reaches the conclusion that the *Southern Company*, therefore, paid in value at least $475,000 for the equitable interest of the stockholders of the Belt Company.

But it must be remembered that the stock of the Southern Company represented *six* companies having a total bonded indebtedness of $29,685,000, of which the Belt Company with its bonded indebtedness of $1,000,000 was three and one-third per cent. It is quite possible, and, in the light of the finding of the master as to the value of the Belt property, practically conclusive that whatever value attached to the stock of the Southern Company which was received by the Belt stockholders was derived from the five companies other than the Belt Company. At the time of the issue of this Southern stock, the Southern Company was the owner of the stocks and bonds of the Belt Company, but not of its physical property. As the value of the physical property of the Belt Company did not exceed its mortgage indebtedness, its stocks and bonds held by the Southern Company could not have exceeded that value.

It is not a question of the *par value* of the stocks and bonds.

(*Knoxville Water Company* v. *Knoxville*, 200 U. S., 22; *Smythe* v. *Ames*, 169 U. S., 466, 547; *Missouri, K & T. Railway Company* v. *Love*, 177 Fed., 403.) The market value of stocks and bonds is sometimes used as a *means* of arriving at the actual value of railroad property, but once the actual value is established, *such value is controlling*. It is submitted, therefore, that the finding of the master in respect to the value of the Belt property is conclusive against the assertion of any claim by the Trust Company in this case.

(f) Furthermore, the court of appeals (210 Fed. 707), as before stated, reaches the conclusion from a consideration of the stocks and bonds of the Southern Company issued in exchange for the stock of the Belt Company that there was an equity in the Belt property over and above its mortgage indebtedness of "at least $475,000." It is *conceded* that the reorganization committee *actually expended* $1,164,172.50 in the payment of floating debts of the companies involved in the reorganization. Nowhere in the master's report (Rec., 859-860) is it stated *what part of the floating indebtedness so paid were debts of the Belt Company*. When the committee had paid the debts of the Belt Company to an amount in excess of $475,000, then upon the court's own theory, what equity was there from which the Trust Company's claim may be satisfied?

XIII.

A resulting trust was created in favor of the railway companies paying for the properties deeded to the Central Company, and this equitable interest passed under the after-acquired property clauses of their mortgages. The Central Company acquired the properties subject to this trust, and the interest of its stockholders was likewise subject thereto. The Trust Company acquired the stock of the Central Company with a knowledge of these facts, and its equities, therefore, are subordinate to those of the Southern Company.

The findings of fact made by the master (Rec. 781-804), conclusively establish that the properties of the Central Company, which by the decree of the lower court were directed to be conveyed to the Southern Company, were purchased with moneys fur-

nished by each of the three mortgagor companies involved, as they were needed by such company for its purposes. The Central Company was merely a holding company which held the title to the properties as trustee for each of the companies furnishing the money, and was in no sense a beneficial owner. The properties were appurtenant and needful for railroad purposes and as such came under the after-acquired property clauses (Rec. 737), of the mortgages of these companies respectively. The master says (Rec., 803):

> The specific properties desired by each of the three railroad companies involved (the Gulf Company, the Belt Company, and the Air Line) *were paid for by and with the moneys of that company and for its purposes.*
>
> The theory upon which the conclusion of the master is reached, is based upon the principle that the Central Company was simply used for the purpose of *holding the titles* to the particular properties belonging to each one of these railroads, and to all intents and purposes it acted as a *trustee*, and was *not* a beneficial owner, the intention being, as already stated, to place these properties beyond the lien of the general railroad mortgage which covered after-acquired properties.
>
> The proofs show that the intervener acquired at the foreclosure sales all the interests of the Gulf, Air Line and Belt companies as to all properties legally covered and included in the mortgages foreclosed; hence it must be shown that the real estate purchases in controversy were appurtenant to the railroads, along which they are contiguous, for if they are not appurtenant and do not come within the class of cases which would otherwise bring these properties within the lien of the general railroad mortgage, then, of course, the titles to such properties did not pass by the foreclosure sales to the intervener, and they would still be in the Central Company, giving value to its stock.
>
> Under the facts, the master finds that a certain portion of said properties were and are *appurtenant and needful for railroad purposes* and are of such character as would come within the after-acquired property clause of the mortgages.
>
> The Belt Company pledged its Central Company stock to the Trust Company for the purpose of securing its large indebtedness to that company, and subject to the rights of the intervener herein the Trust Company has the undoubted right to subject such collateral to the payment of the Belt obliga-

tions to it insofar as it affects the properties which have not been purchased by the intervener at the foreclosure sales.

It is the opinion of the master and he so finds that the intervener is entitled to the judgment, order and decree of this court requiring the Central Company and its receiver to convey to said intervener those portions of said real estate hereinbefore found to be appurtenant to said railroads and included within the after-acquired property clause of their mortgages.

An implied or resulting trust arises from the circumstance of payment alone. It results in this case because the Gulf Company, the Belt Company and the Air Line paid the consideration for the properties, the legal title being taken in the name of the Central Company. (*Osborn* v. *Perkins*, 112 Fed., 127, 131; *Lauter* v. *Trust Co.*, 85 Fed., 894, 903; *Condit* v. *Maxwell*, 142 Mo., 266; *Sanford* v. *Loan Society*, 80 Fed., 54; *Wade* v. *Sewell*, 56 Fed., 129; *Ducie* v. *Ford*, 138 U. S., 587; *Albright* v. *Oyster*, 140 U. S., 493). The payments were presumably made from the proceeds of bonds, since the properties were constructed from money realized from the sale of their bonds (Rec., 737).

In *Central Trust Company* v. *Kneeland*, 138 U. S., 414, the Toledo, Delphos & Burlington Railroad Company executed a mortgage with an after-acquired property clause to the Central Company. Certain terminal properties in the city of Toledo were afterwards purchased by the mortgagor and the title taken in the name of one George W. Ballou, the consideration, however, being paid by the Railroad Company. The court held that the lien of the mortgage attached to the property thus purchased, saying:

> So far as the property standing in the name of Ballou is concerned, he was the financial agent of the mortgagor, the Toledo, Delphos & Burlington Railroad Company, and while he took the title to some properties in his own name, the purchase was with moneys of the mortgagor. Hence, while he held the legal title, the full equitable title was in the railroad company, and that property became, therefore, in equity, subject to the lien of the first mortgage.

To the same effect are *Toledo Railroad Company* v. *Hamilton*, 134 U. S. 296; *Augusta Railroad Company* v. *Kittle*, 52 Fed. 63; *Brady* v. *Johnson*, 26 Atl. Rep. 49; *McGourkey* v. *The Toledo & Ohio Central Railway Company*, 146 U. S. 536; *Contracting and*

Building Company v. *Continental Trust Company*, 108 Fed., 1; *New England Water Works Company* v. *Farmers' Loan & Trust Co.*, 136 Fed., 521.

It is conceded by the court of appeals in its opinion (201 Fed., 827), that a trust resulted in favor of the railway companies, and that the lands were appurtenant to the railroads, and that the terms of the after-acquired clauses of their mortgages, *in each of which the Trust Company was the trustee*, were broad enough to include them. The court says:

> Conceding that the property was appurtenant to the railroad and that the terms of the after-acquired clauses were broad enough to include it, how can this claim of the Southern Company be sustained?

The court then proceeds to state the well-recognized and conceded principle that the mortgagee, by virtue of an after-acquired property clause, takes the property subject to junior liens, encumbrances and equities under which the property comes to the mortgagor. Then follows a statement of the circumstances which, in the opinion of the court of appeals, operates to defeat the equity of the Southern Company, as follows:

> In the case in hand, the Central Company acquired the property here in dispute for its liability to pay its stockholders the par value of its stock and *it held the property in trust to secure the payment to its stockholders of that liability*. The mortgagees under the railroad mortgages and the Southern Company, the purchaser thereunder, knew these facts. They parted with no value on account of this property and a court of conscience may not permit them to deprive the stockholders of the Central Company, who have really paid for it, of the trust property which the Central Company holds to reimburse them unless the court first requires them to pay to the holders of the stock its actual value.

The court adds, page 828 of the opinion:

> The equity of the stockholders as against the Southern Company which took whatever it has with full notice of all the facts in this case, is the same that it would have been if the liability of the Central Company, now represented by its stock for the purchase price of the property, *had been represented by its promissory notes and a mortgage upon this land to secure them* and they had been pledged by their owners to secure their debt to the Trust Company.

(a) If the properties of the Central Company had been taken in the name of an *individual*, instead of a corporation, the consideration therefor being paid by the railway companies, no one would deny that the after-acquired property clauses of the mortgages would immediately attach to them, subject to any liens or claims for unpaid purchase money. Why does the same result not follow when the titles were taken in the name of the Central Company, the purposes of the transaction remaining the same, the only difference being that, in the one case, the legal titles are vested in an *individual*, and in the other case, in a *corporation?* What is the magic surrounding the employment of a corporation for holding the legal title which so alters the situation that after-acquired property clauses of the mortgages become inoperative?

It is submitted that the courts have never before made such a distinction. Where the properties are bought with the funds of the mortgagor for its purposes, it is universally held that the after-acquired property clauses attach immediately, *regardless of the circumstances that the legal title may be vested in an individual or in a corporation.*

The decision of the court of appeals is in *direct conflict* with the case of *Guaranty Trust Co.* v. *Atlantic, etc. R. Co.*, 138 Fed., 517, United States Circuit Court of Appeals, Third Circuit, which sustains our position to the fullest extent.

The facts are as follows: The Atlantic Company had given a mortgage upon all its property existing and to be acquired to the Guaranty Trust Company to secure an issue of 500 bonds of $1,000 each. It afterwards used a portion of the proceeds from these bonds to purchase the property of the Asbury Park & Belmar Street Railway Company from a bondholders' committee which had purchased it at foreclosure sale. *Instead of taking the property of this company in its own name, it determined to organize a new corporation to take it over.* Accordingly, the Asbury Park & Seagirt Railroad Company was organized, which took over the property, *issuing all its capital stock to the Atlantic Company*, and immediately executing a lease of all the property to the Atlantic Company for 99 years. Later, *the Atlantic Company pledged this stock to the Guaranty Trust Company* to secure a loan of $100,000. In a sale under foreclosure of the mortgage mentioned above given to the Guaranty Trust Company as trustee, it was contended

by the Trust Company, and held by the lower court, that its individual lien upon the property of the Asbury Park & Seagirt Railroad Company acquired through the pledge of the capital stock was superior to the lien of the mortgage to secure bondholders of which it was trustee. Upon this point, the lower court was *reversed* upon appeal by intervening bondholders. Gray, Circuit Judge, writing the opinion, said, p. 526:

> As shown in the opinion of the court below, all beneficial interest and ownership in the franchises and property of the Belmar Company, were purchased by and resided in the defendant company, the bare legal title being held by the Asbury Park & Seagirt Railroad Company, as trustee, for the benefit and purposes of the defendant company, which had paid the entire purchase price, and which remained the real equitable owner. The mortgage of July 1, 1896, both expressly and impliedly, covered equitable interest, in after-acquired property appurtenant to or connected with the line of railroad controlled or operated by it. As soon as this equitable interest and ownership in the Belmar property was acquired, as hereinbefore described, by the defendant company, the lien of its mortgage attached itself thereto and remained upon it, both before and after the legal title had been placed in the Asbury Park & Seagirt Company. *Toledo, Delphos, etc. Railroad* v. *Hamilton*, 134 U. S., 296; *Central Trust Co.* v. *Kneeland*, 138 U. S., 414; *Bear Lake Irrigation Co.* v. *Garland*, 164 U. S., 1, 15. To hold that this were not so, *would be to work a fraud upon the holders of these bonds*, who were notified in the bonds themselves, and the declaration is recited in the mortgage, that they were secured by a mortgage conveying to the trustee (the complainant company) "all the certain railroad and other property, real and personal, and franchises of said railroad company, whether now owned or hereafter acquired by it."

The court further says, p. 527:

> As we have seen, the court below, although holding that the real beneficial ownership of and in the franchises and property of the Belmar Company, had been acquired in the manner hereinbefore stated, as an addition to and extension of the line of the said defendant company, and that in consequence, this equitable right and ownership, as well as the legal title in the capital stock of the said Seagirt Company, came under the lien of the mortgage in suit, yet held *that the complainant company, by its holding the pledge of all of said stock, under the circumstances as disclosed in this record,*

had, in its individual capacity, a superior equity to that of the mortgage given to it and held in trust for the bondholders.

In this, we cannot agree. *We do not think that the only way by which the lien of the mortgage upon this equitable ownership of the defendant company "can be enforced is by substituting for the railroad property itself that which fully represents it, namely, the capital stock of and the lease made by the new corporation." This ignores altogether the lien of the mortgage upon the equitable ownership itself. The capital stock held by the defendant company and thus pledged, represented the bare legal title of the property, whose full and entire beneficial ownership prior to the conveyance of the legal title to the Seagirt Company, was in the defendant company, and came, as we have seen, under the lien of the mortgage.* On the transfer of the bare legal title to the Seagirt Company, this equitable interest in the property *remained subject to the lien of the mortgage*, and those who held certificates for any or all of the capital stock held subject to such lien.

In the case before us, the defendant company, as the owner of all the capital stock of the Seagirt Company, may be estopped to assert a legal or equitable right in itself, as against its pledgee of said stock. *The controversy here, however, is not, in this respect, between the defendant company and the pledgee of this stock. It is between the pledgee of this stock and the creditors of the defendant company who hold, by reason of the mortgage in suit, a lien upon the whole beneficial and equitable ownership of the defendant company in the line of railway acquired by it in the manner above described.* If the defendant company had sold a portion of this stock, surely the lien of this mortgage so held in trust for the bondholders, would not have been measurably misplaced by reason of lack of notice to the transferee of the stock, and it is difficult to understand how a pledgee of such stock can be in any different or better position than such a purchaser.

This equitable ownership, being the real and beneficial ownership, and subject to the lien of the mortgage in suit, may be sold under the foreclosure decree, and inasmuch as the Seagirt Company holds the mere naked legal title in trust for the equitable owner, it may be a question whether, as a passive trust, it will not be considered as executed, and the legal title thus pass with the equitable; or it may be a matter for consideration, as to whether any, or what, further proceedings may be necessary to perfect and protect the title of the purchaser. *However this may be, no rights were conferred by the pledge of the stock of the Seagirt Company,*

which were superior to, or could interfere with, the mortgage lien subsisting upon this plenary equitable title for the benefit of the bondholders under the mortgage.

The decision of the court of appeals is also in conflict with the case of *New England Water Works Company* v. *Farmers' Loan & Trust Company*, 136 Fed., 521, Court of Appeals, Seventh Circuit (petition for writ of *certiorari* denied, 197 U. S. 622).

The Water Works Company executed a mortgage upon its plant containing an after-acquired property clause. The title to the property which it was claimed came within the scope of this clause was taken in the name of the *Boston Company*, which executed a mortgage upon the property. It was held that the property standing in the name of the Boston Company came under the after-acquired property clause of the mortgage of the Water Works Company notwithstanding the mortgage of the Boston Company. The court held that the after-acquired property clause attached *regardless of the form which the transaction might take*, saying:

> Here, then, in a sentence is the whole case: A mortgage on a necessarily expanding water works system—looking forward as well as to the present and contemplating that the new property, as fast as created, shall be drawn under the mortgage; a requirement that new property be created, constituting, in connection with the old property removed, the mouth and throat of the whole enterprise; and, finally, the actual creation of such new property, having no function other than to act as mouth and throat for the old. Can anyone doubt, that under such circumstances the new property, *whatever may be the legal form given to it*, is equitably but after-acquired property within the meaning of the mortgage? Does not such a case, on its physical aspects alone, constitute a case of after-acquired property?

In *Farmers' Loan & Trust Company* v. *Denver Railroad Company*, 126 Fed., 46, court of appeals, eighth circuit, it was held that the after-acquired property clause of the mortgage attached to the real estate taken in the name of the Jefferson Investment Company, a corporation formed for the purpose of holding the title to the property. It may be assumed that the capital stock of the company was owned by the mortgagor or in its interest, although that circumstance was not deemed by the court to be of sufficient importance to require any statement concerning it

whatsoever. Why was it not true that the Jefferson Investment Company acquired the property held by it "for its liability to pay its stockholders the par value of its stock," and why did it not hold "the property in trust to secure the payment to its stockholders of that liability," so as to defeat the after-acquired property clause of the mortgage, as is said by the court in its opinion in this case? Why was not the situation the same as it would have been if the liability of the Jefferson Company to its stockholders "had been represented by its promissory notes and a mortgage upon this land," so as to create an equity superior to the mortgage?

The same may be said of the facts presented in *Wade* v. *Chicago Railroad Company*, 149 U. S., 327, 341. There the title to the property, which was held to be subject to the after-acquired property clause of the mortgage, was taken in the name of the *Empire Construction Company* and the court said:

> The "after-acquired clause" in the mortgage of the Chicago, Springfield & St. Louis Railroad Company under the decisions of this court covers all acquisitions made to the property *by either the construction company or others acquiring rights under it.*

The Empire Construction Company had conveyed its rights, including the real estate in question, to Cooley & Co. and that firm in turn had conveyed them to certain newly organized companies, but it was held that even these conveyances did not defeat the operation of the after-acquired property clause of the mortgage.

If the Central Company had made a conveyance of its physical property to the Trust Company, would that have defeated the lien of the after-acquired property clause of the mortgage? Certainly not, since the Trust Company would have taken the conveyance with notice of the rights of the trustee in the mortgage.

In *Central Trust Company* v. *Kneeland*, 138 U. S., 414, 424, property which was taken in the name of the *Toledo & Grand Rapids Railroad Company* passed under the after-acquired property clause of the Toledo-Delphos & Burlington Railroad Company.

In *Augusta Railroad Company* v. *Kittel*, 52 Fed., 63, it was held that the after-acquired property clause of a mortgage of a railroad company covered the equitable title to certain lands,

although the legal title was in the United States and also in the State of Florida.

The views entertained by the court of appeals in this case of the relationship between the corporation and its stockholders are most extraordinary. Broadly stated, the court holds, as we read the opinion, that a corporation holds its property in trust for its stockholders, and that this trust relation is sufficient to defeat the operation of the after-acquired property clause of a mortgage; and that the obligation of a corporation to its stockholders in respect to its property is substantially the same as it would be if the stockholders, in lieu of the stock, held the notes of the corporation secured by a mortgage on its property.

But stockholders possess no such rights. They possess a right to participate, according to the amount of their stock, in the surplus profits of the corporation, and ultimately on its dissolution in the assets remaining after payment of its debts. (Cook on Corporations, Sec. 12.)

Stockholders have no lien or claim against property of the company until all of the obligations, liens, claims, and equities against the company and its property have first been discharged in full.

In the case under consideration, the Central Company took the title to the properties *subject to the resulting trust in favor of the mortgagor companies*. The stock of the Central Company only represented a right to participate in the profits of the concern and in the distribution of its property *subject to this trust*.

What was the situation in its entirety? The Belt Company, taking it for illustration, needed certain terminal properties in Kansas City *for its own use*. It proceeded to purchase such properties indirectly through the Central Company, paying the consideration therefor and taking possession of the property and using it as though it were its own. It employed the device of placing the title to the property in the Central Company under the mistaken idea (*McGourkey* v. *Toledo Railroad Company*, 146 U. S., 536, 566), that the lien of the mortgage would not attach to it, and that the property could be sold, if need be, free from its lien.

If the title had been placed in the name of an individual instead of a corporation, no question would have arisen. But it

was thought a corporation would be more convenient. The Central Company issued capital stock to the Belt Company in an amount corresponding more or less accurately with the purchase price of each piece of property as each sale was consummated. This stock was a mere memorandum or evidence of the amount which each company from time to time had invested in the properties held by the Central Company. The Trust Company knew all about the transactions, as its officers were the officers of the Central Company, as well as of the Belt Company, and the books of the Central Company were kept in the office of the Trust Company. The railroad of the Belt Company was built with the proceeds of its bonds (Rec., 737). The bondholders were advised of this through the terms of the mortgage and they had a right to assume that as the mortgaged property grew it would come under the after-acquired property clause. We think the court of appeals is mistaken in saying (201 Fed., 827) that the mortgagee "parted with no value on account of this property," since it is reasonably certain that it was the proceeds of the bonds of the Belt Company, the Gulf Company and the Air Line, respectively, which furnished the consideration for the properties purchased for them in the name of the Central Company.

It is the particular province of a court of equity to look through a transaction to the substance of it, and to disregard the form or appearance it may take, as was done in the *McGourkey* case, *supra*, where the court said, in speaking of a complicated arrangement for the leasing of equipment to a railway company through the issue of car trust certificates:

> In fine, we are of the opinion that this transaction should be adjudged to be in law what it appears to be in fact, a purchase by the railroad of the rolling stock in question, and that the device of car trust certificates was inoperative either to vest the legal title in McGourkey *or to prevent the lien of the mortgage from attaching to it upon its delivery to the road.*
>
> *Smith* v. *Moore*, 199 Fed., 690;
> *Linn Timber Co.* v. *United States*, 196 Fed., 593.

Let us take, for illustration, the case of the Belt Company with respect to any one of the pieces of property purchased for it with its funds, the title being taken in the name of the Central

Company and the capital stock of the Central Company issued to the Belt Company in an amount corresponding to the consideration paid. Is there any question that while the *legal title* was in the name of the Central Company the *equitable title* was in the Belt Company? We think not. Did the fact that the Belt Company accepted the stock of the Central Company operate to defeat the trust? On the contrary, the position of the bondholders was *strengthened. The Belt Company then possessed every interest in the property which it is possible for it to possess in a court of equity.* It was fortified with both the equitable title to the property itself and the stock of the company representing the property. It was so understood by the parties at the time and in the correspondence, record and books of the companies it is referred to as the property of the Belt Company, which the Central Company holds in trust for it.

Under these circumstances there can be no question that *the Belt Company's interest in this property passed to the trustee under its mortgage by virtue of the after-acquired property clause.* It was appurtenant to the railroad as the master found and as the court of appeals assumes. It was presumably paid for with the proceeds of the bonds, and bondholders had a right to expect that the security of their mortgage would be augmented correspondingly.

The lien of the mortgage having attached to it, it was obviously impossible to *defeat* or *dislodge* that lien by any transfer of stock of the Belt Company or by any act of the Belt Company whatsoever. The equitable title had passed beyond its reach and was securely vested in the trustee for the bondholders. Particularly is this so where the Trust Company cannot claim to be in the attitude of a *bona fide* holder of the stock. Not only was it conversant with all the transactions as above stated, but it was a trustee in the mortgages of the Belt Company, Gulf Company and Air Line. It controlled the affairs of the Belt Company to such an extent that it was able to strip it of all of its portable property when the insolvency of the Belt Company made it apparent that its control over the Belt Company would shortly cease. Moreover, the Trust Company cannot claim that any of its money went into the purchase of these properties. The Trust Company in its answer (Rec., 143) states that the Gulf Company and the Belt

Company "are in equity the *beneficial owners* of all of the property of the Central Improvement Company." They knew this at all times and cannot be heard to say that this beneficial interest did not pass to the trustee under the mortgages. The case of *Watson* v. *Bonfils*, 116 Fed., 157, is not controlling. Had there been involved in that case an after-acquired property mortgage, the equitable title would undoubtedly have passed under it. There is not in this case any express trust which conflicts with the resulting trust arising from the payment by the mortgagor companies of the purchase price of the properties involved.

Our views are strengthened by the language of the court of appeals itself, (201 Fed., 826), where it states that the Trust Company as the holder of the stock of the Central Company acquired an equitable interest in the *property* itself, saying:

> The Trust Company had such an equitable interest in the *property* of the Central Company by virtue of the pledge to it of 1,120 out of 1,407 shares of the stock of that company issued, that the Trust Company's appeal completely challenges the decree of the court with reference to *that property*.

If the possession of the Trust Company of this stock *as pledgee* gave to it *an equitable interest in the property itself*, why did not the *ownership* of the stock by the Belt Company give to it an equitable interest in the property itself which passed under the after-acquired property clause of its mortgage? And if this equitable interest did pass to the trustee, how could it ever have been afterwards divested from the trustee and reinvested in the Trust Company?

Our position finds ample support in the following additional cases:

Pere Marquette Railroad Co. v. *Graham*, 136 Mich., 444;
Columbia Finance & Trust Co. v. *Kentucky, etc. Ry. Co.*, 60 Fed., 794;
Knevals v. *Florida, etc. R. Co.*, 66 Fed., 224;
Omaha, etc., R. Co. v. *Wabash, etc., Ry. Co.*, 108 Mo., 298;
United States Trust Co. of N. Y. v. *Wabash Ry. Co.*, 32 Fed., 480;
Brady v. *Johnson*, 75 Md., 445;
Monmouth County Electric Co. v. *McKenna*, 68 N. J. Eq., 160;

Harris v. *Youngstown Bridge Co.*, 90 Fed., 322;
Contracting & Building Co. of Kentucky v. *Continental Trust Co. of N. Y.*, 108 Fed., 1;
Toledo, etc. Ry. Co. v. *Hamilton*, 134 U. S., 296.

(b) The Trust Company was the trustee in the mortgages or deeds of trust of the Belt Company, Gulf Company and Air Line. As such trustee, it knew that these mortgages, on the faith of which bonds were sold to various investors, contained an after acquired property clause sufficiently comprehensive to impress a lien upon railroad properties purchased by or for the three railroad companies, regardless of whether the legal title was in them or in some trustee for them. It knew this fact also through its interlocking directorates and the intimate knowledge it possessed of all of the affairs of those companies. The mortgages were promises to the bondholders that properties subsequently acquired by the mortgagors, situated as the properties of the Central Company were, would come under the mortgage liens and inure to their benefit, and the Trust Company was a party to this promise. It is true that capital stock of the Central Company was issued to the three railroad companies in amounts corresponding to the moneys advanced by them respectively, but that is unimportant in a court of equity, where the substance is to be regarded and the form ignored.

The Trust Company took the stock of the Central Company together with certain stocks and bonds on March 31st, 1899 (Rec. 753). The Gulf Company became bankrupt April 1st, 1899 (Rec. 754). This collateral was given to secure an existing indebtedness by the same officers, representing both companies. It does not appear that credit was extended by the Trust Company afterward on the faith of such collateral, certainly not in excess of moneys realized by the Trust Company thereafter.

The Trust Company was acting in a *dual capacity*. It was *trustee* for the bondholders under the mortgages with after acquired property clauses which, as the master found, attached to the properties of the Central Company. It also in its *individual capacity* took, or attempted to take, the same properties to secure an indebtedness to it from the Belt Company.

The authorities hold that a trustee, under such circumstances, will not be permitted to take or receive any of the Belt Company's assets or properties and appropriate them as security for its own

indebtedness. The court of appeals for the third circuit (*Guaranty Trust Co.* v. *Atlantic Coast Electric R. Co.*, 138 Federal, 517-530), in a case involving the right of a trustee in a railroad mortgage, carrying an after acquired property clause, to hold property acquired from the mortgagor, subsequently to the mortgage, to secure its own indebtedness from the same mortgagor, says:

> A court of equity cannot countenance such a discrimination, as is sought to be made in this case by a trustee, between property of the mortgagor which it holds in trust, and property of the same mortgagor which it claims to hold in its individual capacity. To do so would be a serious relaxation of the rules which have for long and uniformly governed the administration of trusts, and measured the responsibility of trustees.

In *King* v. *Remington*, 36 Minn., 15, King and his wife made a conveyance of property intended as a mortgage, to one Remington to secure an indebtedness. The court held that Remington, having accepted his deed to certain specific property to be held by him as security for advances made and to be made to King, thereby assumed such trust relations to King and his property as to *disable* him from becoming a purchaser at execution or bankruptcy sale of any property belonging to King, even though it was not of the property included in the trust arrangement. Other cases of similar import are as follows: *Ex parte James*, 8 Ves., 337; *Ex parte Bennett*, 10 Ves., 381; *Poillon* v. *Martin*, 1 Sandf. Ch., 589; *Duncomb* v. *New York, H. & N. R. Co.*, 84 N. Y., 190; *Case* v. *Carroll*, 35 N. Y., 385; *Gardner* v. *Ogden*, 22 N. Y., 327; *Ex parte Hughes*, 6 Ves., 617; *Fulton* v. *Whitney*, 86 N. Y., 548; *Oliver* v. *Court*, 8 Price, 127.

The master held that the rule above stated would not apply in its strictness to the present case. Certain it is, however, that no favorable presumptions attend the act of the Trust Company in undertaking to acquire for itself properties which it undoubtedly knew belonged in equity to the Belt Company, Gulf Company and Air Line, respectively, and which, as such, were impressed with liens in favor of their bondholders for whom it was acting as trustee.

The court, we respectfully submit, *should not be astute to reward the Trust Company for preferring itself, in its individual capacity, to the bondholders whom it represented in a fiduciary*

character of the highest order. Particularly is this true when it stands admitted that the properties in question were bought and paid for by the mortgagor companies with their own funds, and that the Trust Company not only contributed nothing toward their acquisition, but *through the action of common officers and directors* took the stock of the Central Company to secure an antecedent indebtedness at a time when by reason of the insolvency of the Gulf Company it saw that the Gulf Company, Belt Company, Air Line and their allied enterprises were facing financial disaster.

XIV.

Even if it should be held that the Trust Company has a right of recovery (which we strenuously deny) it should be limited to such equitable terms as in the opinion of the court should have been offered it at the time of the reorganization.

At the time of the reorganization there was a disputed claim as to the indebtedness of the Belt Company to the Trust Company. There was involved a very long accounting between the two companies covering a period of years. The Trust Company had controlled the Belt Company and its allied terminal companies during these years, and it was thought that its charges had been excessive, and that on a true accounting it would appear that instead of the Belt Company being indebted to the Trust Company the contrary was the fact. *Both* parties regarded such accounting as necessary. It appears from the stipulation dated November 12th, 1901, (Rec. 890), that prior to that time the receivers of the Belt Company had filed a crossbill against the Trust Company demanding an accounting, and it was agreed in the stipulation that *an accounting should be had* upon an amended crossbill or ancillary bill, and that the accounting should be expedited, and that when it was concluded, a judgment should be entered in favor of the Trust Company if it should be successful, or in favor of the Belt Company if that company should be successful.

The Trust Company in the stipulation was represented by Judge Francis M. Black, formerly Judge of the Supreme Court of Missouri and one of the ablest lawyers of our State. The ancillary bill was filed according to the stipulation and the Trust Company answered setting up various defenses, including the stat-

ute of limitations. The proceeding thus begun did not reach a termination until June 25th, 1910, and then *for the first time* the state of accounts between the Belt Company and the Trust Company was judicially determined.

At the time of the reorganization it was not possible to have offered to the Trust Company equitable terms in income bonds or preferred stock *since no one knew whether the Trust Company was in fact a creditor or not.* Its debt was honestly disputed, and neither the parties nor any court, in advance of an adjudication, could have prescribed fair or equitable terms.

Under these circumstances, should the Southern Company be *penalized* for failing to do what was obviously an impossibility? The Southern Company should not be penalized for its failure to make to the Trust Company a fair offer either at the time of the reorganization or at the time that its debt was first established in June, 1910. The same court which, for the first time adjudicated the state of accounts between the two companies, also adjudicated that there was no equity in the Belt property available to creditors, and hence there was no obligation to offer terms; in fact, the doctrine that an interest to stockholders can be preserved by the issuance to creditors on equitable terms of income bonds or preferred stock was first announced in the *Boyd* case in April, 1913.

It is respectfully submitted, therefore, in view of the circumstances, that if the Southern Company, in any possible view of the case, should be held liable in this action, it ought not in equity to be required to pay to the Trust Company the full amount of its debt with the accumulated interest. Should not the court under such circumstances prescribe such equitable terms as should have been offered at the time of the reorganization if the Trust Company's debt had been then liquidated? Does it not appeal to the conscience of the Chancellor to adjust the Trust Company's claim, in the event that its claim is deemed valid, to the position which it would occupy now, if such equitable terms had been offered then? As stated in our application for *certiorari* if the Trust Company had been given par in the preferred stock of the Southern Company at the time of the reorganization, it would have received $360,000 par value, the average price of which during the year 1900 was $33.75, aggregating $121,500. If you add to this

sum the dividends that would have been paid on the stock, together with interest at 6% on the dividends from time of payment to date (May, 1915), the aggregate amount would be approximately $280,000. Or if you take the present market value of the stock at 59, together with the dividends paid and interest on dividends at 6% to date, the amount would be approximately $370,000. The judgment sought to be enforced against the Southern Company is over $800,000, or $430,000 more than the Trust Company would have realized if the rule of equitable terms in the *Boyd* case had been anticipated, and could have been carried out at the time of the reorganization.

The Southern Company has done nothing to forfeit its right to equitable consideration. The Belt Company and its receiver not only had the legal right to have the account between the two companies sifted by the process of an accounting to ascertain if the Trust Company had abused its power in imposing unrighteous debts and obligations upon the Belt Company, but it was considered a duty so to do, and the court appointing the receiver approved. The situation was such that Judge Black believed there should be an accounting, and he stipulated to that effect. Not until October 22nd, 1912, was there any judicial determination that the Southern Company was in any way liable for the debt of the Belt Company, nor until December 2nd, 1913, was that decision reaffirmed by the court of appeals.

We think it would be a most unjust result if the Trust Company should be permitted to retain the enormous benefits which it received under the reorganization plan, and at the same time hold the Southern Company liable for its debt against the Belt Company. And the harshness and, as we think, the injustice of such a result would be greatly intensified if this court should hold, as did the court of appeals, that the doctrine of offering equitable terms to creditors, announced in the *Boyd* case, should be disregarded, and the Trust Company should be permitted to recover a personal judgment in an amount exceeding by at least $430,000 what such equitable terms would have amounted to.

XV.

There was no exception to the master's report in the court below challenging the correctness of his finding that the Southern Company was not liable for the floating indebtedness of the Belt Company. The decision of the court of appeals that such finding can be reviewed in an appellate court in the absence of exceptions is erroneous.

The Trust Company excepted to the *report* of the master (Rec., 893), for the reason that,

> The master has in his report stated as follows: "That the Southern Company is not in any way liable for the floating indebtedness of the Belt Company;" whereas, the master in his report should have *omitted reference to or recommendation concerning* the question of the liability of the Southern Company for said floating indebtedness of the Belt Company for the following reasons:

The grounds specifically assigned were that that issue was not properly in the case for various reasons, but it was nowhere stated that the issue had been decided *incorrectly*.

The assignment of error in the court of appeals (201 Fed., 817) was that the court erred in *including* in said decree the finding that the Southern Company did not assume or agree to pay or become liable for the indebtedness owing by the Belt Company to the Trust Company.

It is not a case where the Trust Company "intended to present the question of the liability," but it is a case where the Trust Company intended *not* to present that question for decision. Its whole attitude was the strongest evidence of a desire to *escape* a determination of that question, and it framed its exceptions to the master's report and its assignments of error for that specific purpose.

The Trust Company itself, in its return to a rule to show cause, etc. (Rec. 970), said:

> That by reason of the former decision of this court, and by reason of the state of the pleadings and record in the cause from which this appeal is taken, *the question of the personal liability of The Kansas City Southern Railway Company for the debt of the Belt Company is not in issue and cannot be determined upon this appeal.*

It was the deliberate purpose of the Trust Company to avoid any exceptions to the master's report which would challenge the *correctness* of the master's findings on the liability issue or which would *permit* or *require* a decision by the court of appeals.

It cannot be plausibly claimed that the exceptions filed in the court below by the Trust Company met the well established rule requiring definiteness and certainty so as to challenge the *correctness* of the ruling of the master on the liability issue. Aside from the fact that they were not *intended* to do so, they utterly failed to apprise the opposite party that it was called upon to meet this issue, nor did they advise either the master or the court that the Trust Company sought to controvert the master's finding in that regard. In *Sheffield Railway Company* v. *Gordon*, 151 U. S. 285, 290, this court points out that this degree of definiteness and certainty is required:

> Proper practice in equity requires that exceptions to the report of a master should point out specifically the errors upon which the party relies, not only that the *opposite party* may be apprised of what he has to meet but that the *master* may know in what particular his report is objectionable and may have an opportunity of correcting his errors or reconsidering his opinions.

To the same effect are:

> *Columbus Railroad Company Appeals*, 109 Fed., 177, 219;
>
> *Sanford* v. *Embry*, 151 Fed., 977, 982;
>
> Vol. II, Street on Federal Equity Practice, Sec. 1486;
>
> Vol. II, Foster's Federal Practice, Sec. 315.

(a) Under this state of the record it was not a question of the assignment of errors, or specification of errors, or the power of the court to notice a plain error. *There would be nothing here to review even if the appellant at the time of taking its appeal had specifically assigned as error the ruling of the court upon the liability issue.*

Assignments of error are directed to the action of the *lower court* and are not directed to the action of the master in his findings of fact or conclusions of law, which are not excepted to.

It is true, as this court says in its opinion (201 Fed., p. 818), that an appeal in a suit in equity involves a trial *de novo* in the

appellate court and entitles the appellant to a just decree, and it is also true, as the court says on the same page, that this court may consider a plain error not assigned when a failure to do so would result in a great injustice.

But a hearing in an appellate court in an equity case is a trial *de novo* of the *case before the court*, as it was presented to that court, and as that court passed upon it, but not of the case *before the master*, and the power of this court to notice a plain error means that it may consider and correct an error of the *lower court*, but not an error which may have been committed by the *master*. The power of the court to notice a plain error merely *supplies the omission of an assignment of error.*

What is before the lower court upon the coming in of the master's report in an equity case? The answer is plain, that the master's report is to be taken as correct by the court, as assented to by the parties, except in so far as matters of law and fact are properly excepted to by the parties.

In *Metsker* v. *Bonebrake*, 108 U. S., 66, 72, this court says, in speaking of the functions and duties of the lower court under these circumstances.

> The findings of the master are *prima facie* correct. Only such matters of *law* and of *fact* as are *brought before the court by exceptions* are to be considered, and the burden of sustaining the exceptions is on the objecting party.

If the only matters before the lower court are those portions of the master's report to which exceptions are filed, as this court says, and the court accepts and incorporates in its decree the unchallenged portions of the master's report, how can the lower court be convicted of error for so doing?

The Trust Company had its election to except to the correctness of the master's *conclusions* on the liability issue, and it concluded that it would not challenge that portion of the report, contenting itself with saying that that issue was not properly in the case. We contend that the conduct of the Trust Company in omitting to except to the report of the master precludes it from raising that question upon appeal, *and this would be true even if it had assigned this question as error in the most formal and solemn manner in taking its appeal.*

The decision of the court of appeals is in conflict with the

case of *Burns* v. *Rosenstein*, 135 U. S. 449. There it was duly assigned as error that the court below erred in acting upon the master's *interpretation* of certain articles of the partnership contract as a valid part of his report; in construing the partnership contract as requiring losses of capital to be borne by the partners in the same proportion in which the contract provided for the distribution of net profits, etc. It is to be noted here that the error complained of was *duly assigned*, which would at least have as great an effect as if the court on its own motion should undertake to notice a plain error. It was held, however, that these questions could not be raised by the appellant, for the reason that no exception had been taken to the report of the master in the court below, and the lower court could not be convicted of an error in basing the decree upon those portions of the master's report to which no exception had been taken. The court said:

> These questions are not open to appellants in this court. The decree below followed the report of the special master. And that report was based, in part, upon statements drawn from the books of the parties by the accountants selected by them respectively. Those statements contained the undisputed and disputed items in separate columns. The defendants did not file with the master or in court any exceptions to the report. If the statements by the accountants, or the report of the special master, were based upon any particular interpretation of the articles of partnership that was prejudicial to the defendants, it was their right to file exceptions to the report. The master was directed to report all issues of fact made by the pleadings, and take an account of the dealings and transactions between the parties, and all claims for damages arising out of said transactions. He could not intelligently discharge that duty without adopting some theory as to the scope and effect of the partnership agreement. If he went beyond the order of reference, or if the account taken by him involved a misconception of the provisions of that agreement, the defendants should have brought those matters to the attention of the court by exceptions to the report. *Having failed to do this they cannot in this court for the first time object that the master proceeded upon erroneous views as to the contract between the parties.* (Equity Rule 83; *Brockett* v. *Brockett*, 3 How. 692; *McMicken* v. *Perrin*, 18 How. 504, 506; *Story* v. *Livingston*, 13 Pet. 359, 366; *Medsker* v. *Bonebrake*, 108 U. S. 66, 71).

It is to be noted that the case just cited was an appeal in a suit in equity, and that it involved a trial *de novo* in the appellate court, which, as the court of appeals well says, entitles the appellant to a just decree, and that this court, instead of being called upon to notice a plain error, had before it a proper assignment of error made at the time the appeal was taken as required by law.

In *Coghlan* v. *South Carolina Railroad Co.*, 142 U. S., 101, 115, with which we think the decision of the court of appeals is in conflict, error was *duly assigned* that the lower court did not include interest for three periods of six months each. The court refused to consider the question, saying:

> Having failed to except to the report upon the ground that it did not include them, we do not think that the appellant should be now heard to urge this as an objection to the final decree.

The decision of the court of appeals is also in conflict with the case of *Topliff* v. *Topliff*, 145 U. S., 156. There an assignment of error properly raised the question of the inadequacy of damages awarded, but as no exceptions upon this ground were made in the court below to the master's report, this court declined to consider the question, saying, page 173:

> Proper practice requires that objections to a master's report shall be taken in that court, that any errors discovered therein may be rectified by the court itself or by a reference to the master for a correction of his report without putting the parties to the delay and expense of an appeal to this court. *It would be manifestly unjust if this court after having affirmed the action of the court below in every other particular, should take up an error in a master's report which was not called to its attention and reverse the case upon that ground, when if exception had been duly taken the error could have been at once corrected.* There is nothing in this case to indicate that this point was ever made before the master, nor is it noticed in the eight exceptions taken to this first report, which was set aside upon other grounds, or as already observed in the exceptions to his final report.

The decision of the court of appeals is also in conflict with two following decisions of courts of appeal of other circuits.

In *Provident Life & Trust Company* v. *Camden Railway Company*, circuit court of appeals, third circuit, 177 Fed., 854, 859,

the assignment of error properly made alleged that the principal sums evidenced by the bonds in question were not due and payable. It was held that although the error in the court of appeals was *properly assigned* (which would be at least equivalent to the action of the court in noticing a plain error), yet inasmuch as the particular complaint had not been presented to the lower court by the way of exceptions to the report of the master, the appellant could not be heard upon appeal. The court said:

> This was one of the matters specifically referred to the master to ascertain. The language of the order of reference in that respect has already been given. It will be recalled that he was "to ascertain and report what is now due and payable to the complainant, trustee, for principal and interest upon the two mortgages made to it by the defendant." Killion, although not entitled to be present and heard in view of the interlocutory decree standing against him, nevertheless attended before the master, was heard by him, and later was permitted to, and did, file exceptions to his report; but he did not except to the master's explicit finding that the principal and interest of the bonds were due. *Having failed to raise the question below, although given the opportunity, he ought not to be permitted to raise it for the first time on appeal*, and this irrespective of the fact of the decree *pro confesso* standing against him.

In *The City of New Orleans* v. *Fisher*, 91 Fed., 574, circuit court of appeals, fifth circuit, it is held that questions concerning the correctness of the master's findings, which were not raised by proper exceptions to his report, could not be made the ground of assignments of error on the appeal. The court said, page 581, after setting out the *assignment of error*:

> The grounds stated in this assignment form no part of the exceptions filed to the master's report and it can hardly be said that the judge below erred in this respect when his attention does not appear to have been called to it.

In *New Orleans* v. *Fisher*, 180 U. S., 185, being the opinion of this court in the same case reported in 91 Fed., 574, it is said:

> Fourteen errors were assigned in the circuit court of appeals, which were considered and disposed of *seriatim*. Many of these alleged errors raised questions *not within the exceptions to the master's report*, and in any view we think the case may be determined without minutely retraversing the ground.

The court further says:

> The facts are not in controversy, and the questions raised or attempted to be raised are questions of law.

In *McMicken* v. *Perrin*, 18 How., 507, the court said:

> This court will *not* review a master's report upon objections taken here for the first time.

In Volume II, Street on Federal Equity Practice, Sec. 1476, it is said:

> As exceptions furnish an appropriate procedure for reviewing the master's report, so they supply the only means whereby defects of the kind now under consideration can be reached. Findings of the master on questions of fact are always binding where no exceptions are taken, or where they are improperly taken. Only such matters of *law* and of fact as are brought before the court by exceptions will be reviewed and the burden of sustaining the exceptions is on the objecting party.

Perhaps the best statement of the rule is contained in 17 Enc. Pl. & Prac., 1047, as follows:

> Upon the coming in of the master's report it will be received as true when no exception is taken thereto, and, if some exceptions are filed, the portions of the report not excepted to will be taken as correct, not only as regards the *principles* but as relates to the evidence upon which they are based. And of course exceptions to the report which are not presented upon the coming in of the report cannot be made on appeal.

In *Third National Bank* v. *National Bank*, 86 Fed., 852-858, court of appeals, fifth circuit, the court said:

> There is nothing to indicate that the point was made before the master or before the circuit court in its consideration of the exceptions to the master's report. It is not mentioned in the assignments of error and therefore the suggestion comes to us in a manner which does not warrant us in entertaining it or allowing it, however sound it may be and prevalent it might have been if it had been duly made.

In *Brockett* v. *Brockett*, 3 How., 691, the court says:

> And to some of the items allowed by the master, objections are made before this court. But it does not appear that these objections were brought before the lower court by ex-

ceptions to the master's report. The seventy-third chancery rule is decisive on this subject. It provides that "the parties shall have one month from the time of filing the master's report, to file exceptions thereto, and if no exceptions are within that period filed by either party, the report shall stand confirmed on the next rule day after the month is expired." No exceptions having been filed in the circuit court to the report of the master, none can be heard in this court.

In *Hudgins* v. *Kemp*, 20 How., 45, the court said:

> It is also insisted, that the court below erred in decreeing the rents and profits of the lands in controversy against the defendant, Robert Hudgins, for the reasons that it is not shown that he was in the possession and enjoyment of the same; and also, that the court erred in decreeing these rents and profits from the filing of the petition in bankruptcy, instead of from the decree declaring J. L. Hudgins a bankrupt.
>
> The short answer to each of these objections is, that no such exceptions were taken to the report of the master, and are, therefore, not properly before us. That was the time and place to have presented these questions, and the omission precludes any question here on the matter.

To the same effect see *Story* v. *Livingston*, 13 Peters, 359; *Mason Lumber Co.* v. *Buchtel*, 101 U. S., 633; *The Vanderbilt* v. *McKibbon*, 6 Wallace, 225.

The case under consideration furnishes an apt illustration of the necessity of the rule requiring exceptions to the findings of the master upon matters of *law* as well as upon matters of fact. The master's report comprised some five hundred pages, and contained a digest of thousands of pages of testimony and a consideration and determination of a multitude of legal propositions involved in this most complex and confusing litigation. Is the trial court expected to grope through this bewildering maze with a search warrant to find errors of which one or the other of the contending parties may complain? Should not the party dissatisfied with any particular finding of fact or conclusion of law be called upon to point it out to the court, and should not the court be justified in assuming that such portions of the report as are not excepted to are acquiesced in by the contending parties. If one of the parties undertakes to file exceptions and to point out to the lower court his specific objections to the report and the court passes upon the exceptions filed, assuming, as he has a right

to assume, that other portions of the report are acquiesced in, should not the parties upon appeal be confined to their exceptions thus taken in the lower court? If a party *purposely* and *intentionally* omits to except to a conclusion or finding of the master, should the lower court be required to grope through the master's report in order to pass upon the finding or conclusion against the *implied protest* of the interested party, and should an appellate court be at liberty to reverse the lower court if it fails so to do?

We do not believe that the case of *Sheffield Railway Company* v. *Gordon*, 151 U. S., 285, 293, was intended to modify the rule of the foregoing decisions of this court. There exceptions to the master's report had been filed.. The court stated that there were *two difficulties in the way of considering the case upon these exceptions, first*, because the exceptions were too broad, and, *secondly*, because the master did not send up the entire evidence with his report, so that it was impossible to impeach his conclusions. It is true the court says:

> It is true that if the report of the master is clearly erroneous in any particular, it is within the descretion of the court to correct the error, but we see no reason for exercising such discretion in this case.

The court had been speaking of the proper proceeding before the *master* and before the *lower court*, and it is quite probable that in the quotation above referred to the Court is speaking of the rule which should control the *lower court*, and not a rule which would be applicable in an appellate court. Particularly would this appear so in view of the fact that there is no reference to the line of authorities above referred to, holding in no uncertain terms, that no issue in a case heard before a master is presented in an appellate court, in the absence of an exception to the report pointing out the particular matter complained of, so that the master, the lower court and opposing counsel may be advised in what particular the report is objectionable.

(b) The court of appeals determined however, that an exception to the correctness of the master's conclusion on the liability issue was unnecessary, and that the court therefore was at liberty to consider that question *in the absence of any exception*. It says:

> Moreover the conclusion here challenged was a mere

> deduction from the facts disclosed in the master's report, and where it appears on the face of the report that the master has drawn an erroneous conclusion from the facts he found, *the absence of an exception does not disable the court from correcting the error and entering a just and final decree.*

It is submitted that the rule stated by the court is in conflict with the settled rules of this court, and it is believed, furthermore, that the authorities cited by the court of appeals do not sustain its conclusion.

The cases cited refer for their authority to 2 *Daniel's Ch. Plead. & Pr. p.* 1310, where the author says:

> Where the master by his report states all the facts correctly, but is mistaken as to the legal consequences of those facts, it is not necessary for the party dissatisfied with the master's finding, to except to the report, as the question decided by the master may be opened *upon further directions* without exceptions.

The author refers as authority for this statement to *Thomas* v. *Claxton,* 6 Ves. 226, and *Branger* v. *Chevalier,* 9 Cal. 353.

In the first of these cases it is held that the court to which the master makes his report may, *prior to final decree,* inquire whether, upon the entire report, the master's conclusion is right. This is no more than saying that the lower court, with the master's report before it, may, in the exercise of its discretion, take such action upon the report and render such decree as right and justice may require. This is far from a ruling that matters in the master's report, which have passed unchallenged in the lower court, may be reviewed on appeal.

In *Branger* v. *Chevalier,* the questions sought to be reviewed upon appeal had been appropriately challenged in the lower court. It is there said:

> But when the alleged error consists in the final conclusions of law or fact drawn from the testimony, and the evidence is certified to the court by the referee, the proper course is to move to set aside the report and for a new trial. This was done in this case.

Under these circumstances it was held that the appellant had the right "to raise the question as to errors apparent upon the face of the report itself."

The rule that the court to which the master's report is addressed reserves full control over it, as well as over all other proceedings in the case prior to final decree, is recognized in *Celluloid Manufacturing Company* v. *Manufacturing Company*, 40 Fed. 477, referred to by the court, where it is said:

> Where the master by his report states the facts correctly but errs as to the legal conclusion, the party against whom he errs is not required to except to the report but may bring the question to the attention of the court upon further directions; or if the report is made pursuant to an interlocutory decree, when the cause comes on to be disposed of by a final decree (2. *Daniel's Ch. Pr.* 149). *The cause remains under the control of the court until disposed of by a final decree* and until then it can revise the interlocutory decree or any proceeding in the cause; and it is its duty to correct any error of the master affecting the merits, as well as any error of its own, properly brought to its knowledge.

These cases come within the rule that the filing of exceptions to the report of the master may be permitted after the expiration of the regular time for filing, in case of accident, mistake or surprise (16 *Cyc.* 451).

This is not a case, however, where the lower court, of its own motion, or at the instance of any party to the cause, undertook to review the conclusions of law, upon the liability issue made by the master. Nor is it a case where the court enlarged the time for the filing of exceptions by the Trust Company. It is a case where the Trust Company *deliberately omitted* to file any exceptions which would question the correctness of the master's conclusion upon the liability issue, and *studiously avoided* taking any step whatsoever which would invite or permit the court to review the master's conclusions. There were no "further directions" of the lower court which had the effect to "open" the liability question.

The case of *Burke* v. *Davis*, 81 Fed. 907 (court of appeals, seventh circuit) is also referred to. There the case "was referred to a master" but it does not appear that the master was empowered to state his conclusions of *law* as well as his findings of fact. The court followed the rule stated in 2 *Daniel's Ch. Pr. p.* 1310, and *Hays* v. *Hammond*, 162 Ill. 133, saying:

> In the absence of exceptions to the report, there can be

> no inquiry into the correctness of the master's findings of fact; but whether the proper decree was entered upon the report is nevertheless open to consideration. The master's mistaken apprehension of the legal consequences of the facts reported as Daniel states it, "may be opened upon further directions, without exceptions."

The master only reported the facts. He apparently was not commissioned to find the law, as well as the facts. How, then, could exception have been taken to his conclusion of law? There is no reference whatever to the controlling case of *Medsker* v. *Bonebrake*, 108 U. S., 66, or to the many cases decided in the national courts which are cited in this brief. It is significant that the case of *Burke* v. *Davis* has never been cited or referred to by any court since its decision in 1907.

However, the same court of appeals for the seventh circuit, in a later case (*Sanders* v. *Village of Riverside*, 118 Fed. 720), sustains our contention to the fullest extent. The complainant, Sanders, filed his bill against the Village to quiet title to certain real estate. The Village filed a cross bill setting up its title and possession, praying that its title be quieted. By agreement it was ordered by the court that the cause and cross-cause be referred to a master to report to the court his conclusions of fact and of law. The master found that Sanders was the owner and entitled to a decree quieting his title. The Village filed no exceptions to this portion of the report. The court held that as the reference was of the law and of the fact, by consent of the parties, the master's report was conclusive as to all issues of fact or of law, not specifically excepted to in the lower court, saying:

> The parties agreed to a submission of the whole cause to a master to find the facts and the law. The finding came into this court conclusive upon both parties, except insofar as they should file exceptions. The Village filed no exceptions to the finding that Mr. Sanders was the owner of and entitled to a decree quieting his title to the alley parts. The correctness of that conclusion, therefore, is not now in controversy; citing *Kimberly* v. *Arms*, 129 U. S. 512; *Davis* v. *Schwartz*, 55 U. S. 631; *American Telegraph Co.* v. *Western Union Telegraph Company*, 69 Fed. 666; *Farrar* v. *Bernheim*, 75 Fed. 136; *Bosworth* v. *Hook*, 77 Fed. 686.

In *Walker* v. *Kinnare*, 76 Fed. 101, the same court of appeals holds that an order of reference "to take proof of the is-

sues joined in said petition, answer, and replication, and to report the same to this court, with his conclusions thereon as to the amount of damages, if any, which the claimant is entitled to recover under the issues," refers the whole case to the master, and not merely the question of damages; and that the findings of the master upon such a reference, by consent of the parties, are to be treated as presumptively correct. The court, after stating that the master under the order, was required to report his conclusions of law, as well as his conclusions of fact, upon the merits of the case, said:

> The findings by the master upon a reference by consent of the parties are to be treated as presumptively correct, and the burden is cast upon the excepting parties to show error in them. The report is not to be disregarded upon any light ground; but as Mr. Justice Field observes in *Kimberly* v. *Arms*, 129 U. S. 512, 9 Sup. Ct., 355, the findings of the master, like those of an independent tribunal, "are to be taken as presumptively correct, subject, indeed, to be reviewed under the reservation contained in the consent and order of the court, when there has been manifest error in the consideration given to the evidence, or in the application of the law, but not otherwise."

In a later case in the court of appeals of the same circuit (*Home Land & Cattle Company* v. *M'Namara*, 111 Fed., 822), the rule for which we are contending is clearly recognized. It is there held:

> Where a cause has by consent been referred to a master to make findings on all of the issues, both of fact and law, a party may file exceptions to the master's conclusions of law after the report has been filed in court, under equity rule 83, notwithstanding his failure to file any exceptions before the master.

The court said:

> It is said, however, that the appellants failed to avail themselves of the right to question the ruling of the court below by their omission to take proper exception to the findings of the master in chancery. The case of *Kimberly* v. *Arms*, 129 U. S., 512, 524; 9 Sup. Ct., 355; 32 L. Ed., 674, is cited in support of the doctrine that, where parties have consented to a reference to a master to hear and decide all the issues of the case, and report his findings, both of fact and of law, "his determinations are not subject to be set aside

or disregarded at the mere discretion of the court." It is true that the court in that case remarked that such findings, "like those of an independent tribunal, are to be taken as presumptively correct, subject, indeed, to be reviewed under the reservation contained in the consent and order of the court, when there has been manifest error in the consideration given to the evidence or in the application of the law, but not otherwise." It is not necessary, however, in the case at bar, to determine what would have been the effect of a failure to take exception to the findings of the master upon a question of fact, or his omission to make material findings of fact. It is sufficient to point to the fact that the exception to the construction given by the court to the ninth clause of the contract was taken in apt time within the rule indicated in *Kimberly* v. *Arms*. After the report of the master was filed, the appellants filed in the circuit court proper and specific exception to the master's *conclusions of law* upon the very ground which is involved in the foregoing discussion, and upon the contention that the only damages which the appellees could be allowed were to be computed upon the difference between the market value of the cattle at the time of the delivery and the price which was agreed to be paid.

There is a diversity of views in the State courts upon the necessity of the filing of exceptions to the conclusions of law in reports of masters and referees, which is due in many instances to controlling statutes relating to statutory reference, and due also to the merging of equitable and legal forms. In general, however, (except in Illinois, West Virginia and Mississippi, which appear to follow the text of 2 Daniel's Ch. Plead. & Pr. 1310, without consideration of the reason on which it is based) the rule may be stated as follows:

Where there is no controlling statute, and the general rules of equity practice obtain, it is held that *exceptions to the master's conclusions of law must be filed before the lower court in order that there may be a review of the question in an appellate court.* Thus, in *Hendrix* v. *Holden*, 36 S. E. (S. C.), 1010, it is said:

> The very object of exceptions is to point out the exact errors of law and fact made in the report of a master or a decree of a circuit judge. All the issues of law and fact were committed to the decision of J. W. Hollerman as master. When his report was made, it was binding on all the parties unless excepted to, and such exceptions are required to set out in what particulars there was error committed by the

master. Unless exceptions are taken, the circuit judge must make the findings of fact and conclusions of law of the master the basis of his judgment or decree. It is not in the power of the circuit judge to disregard the machinery provided by law for the conduct of business in our courts. When parties litigant confide the trial of all issues of law and fact to the master, they are entitled to have the report of such master on all such issues confirmed by the judgment of the circuit court unless excepted to; and in the event of exceptions, the circuit judge is limited to those exceptions, and he cannot of his own motion, go outside of these exceptions. This is not to be viewed as a hardship to the circuit judge, no more than the requirements of our constitution that the Supreme Court of the state shall not pass upon facts in a law case. Inasmuch as the master passed directly upon the validity of the administratorship of William Holden, and held that he was such administrator, and there were no exceptions to such findings of fact and conclusions of law by the master, it is not an open question, so far as the parties to this action are concerned, whether such findings of the master are conclusive. And it is just as imperative on the circuit judge.

Other cases of a similar import are as follows:

Young v. *Young*, 63 S. E. Rep., 748 (Va.);
Thompson v. *Mason*, 42 Atl. Rep., 314 (Me.);
Ivarson v. *Mulvey*, 60 N. E. Rep., 477 (Mass.);
Battery Park Bank v. *S. W. Carolina Bank*, 50 S. E. Rep., 848 (N. C.);
Rodgers v. *Rodgers*, 47 S. W. Rep., 701 (Tenn.);
National Exchange Bank v. *Preston*, 33 S. E. Rep., 546 (Va.);
Jackson v. *Pleasanton*, 43 S. E. Rep., 573 (Va.);
Lockhaven Trust Company v. *Trust Company*, 81 Pac. Rep., 804 (Colo.);
Handley v. *McKee*, 70 S. E. Rep., 94 (Ga.);
Taylor v. *Savings Bank*, 61 L. R. A., 900 (Ky.);
Momsen v. *Atkins*, 81 N. W. Rep., 647 (Wis.);
Bender v. *Matney*, 122 Mo., 254;
Tyler v. *Willis*, 33 Barb., 333;
Amboy v. *Byerly*, 13 Mich., 439, 444;
Iron Works v. *Lumber Co.*, 106 Pac., 1124 (Wash.);
Camp v. *Mayor*, 47 Ga., 414.

Even where the statute provides for the filing of exceptions to the report of a master or referee, without specifying that the exceptions shall be to findings of fact or conclusions of law, it is held that only such matters of *law* as well as of fact are open for review in an appellate court as are properly excepted to in the lower court. Thus 2012 R. S. Mo., 1909, is as follows:

> All exceptions to the report of referees shall be in writing and filed within four days in term after the report is filed and shall be argued without delay.

Under this statute it is said by the Supreme Court of Missouri, *State ex rel Wayne County* v. *Woods,* 136 S. W. Rep., 337 (1911):

> In reference cases the referee is required to make and report his rulings both on the evidence and the law, and the errors he makes are called to the attention of the trial court by specific exceptions to be filed within four days. The errors of the trial court are called to the attention of this court through his ruling upon these exceptions.

The statute in some cases expressly requires findings of fact and conclusions of law to be separately stated, and that all portions of the report not excepted to shall stand as the finding and judgment of the court. In *Bounder* v. *Hinckley,* 60 Ia., 185, it is said:

> The question presented here is whether in a case where a report of a referee has been confirmed and judgment rendered accordingly, the appellant can be allowed to present for our consideration questions which do not appear by proper exceptions to have been specifically presented to the consideration of the court below. The appellant in the case at bar insists that he can. He insists that all questions which can be raised in respect to the correctness of the report must be deemed to have been presented in a general way to the court below, when it was asked to confirm the report and that such general presentation is sufficient. But it will be seen at once that if his position is correct, it becomes the duty of the court, in every case referred and reported upon, to examine the entire record with the same care as if the case had not been referred. We do not think that such has been the practice, and if we should sustain the rule contended for, it appears to us that we should impose upon the courts a great burden of which they have deemed themselves relieved, and should go far toward destroying all value of a reference.

Section 2821 of the code provides that "the report of the referee on the whole issue must state the facts found and the conclusions of law separately, and shall stand as the finding of the court, and judgment may be entered thereon in the same manner as if the action had been tried by the court. The report may be excepted to and reviewed in like manner." While the foregoing provision may not be as clear in all respects as might be desired, it is certain that it contemplates that where a report is to be reviewed, exceptions should be taken to it as the foundation of the review. The following cases, though containing no ruling upon the precise point before us, indicate to some extent what has been deemed the correct practice; *Roberts* v. *Cass*, 27 Iowa, 225; *Edwards & Beardsley* v. *Cottrell*, 43 Iowa, 194, and *Washington County* v. *Jones*, 45 Iowa, 260. It appears to us, therefore, that where the appellant desires to assail the report, he should file exceptions to the same in the trial court. The appellant in this case having failed to do so, errors assigned upon the report present, we think, nothing for our review.

XVI.

The reference to the master of all the issues of fact and of law involved in this appeal was made by consent of parties. The failure of the Trust Company to except to the Master's finding on the liability issue prevents it from raising that question upon appeal.

All the issues involved in this appeal arise upon the intervening petition of the Southern Company and the Trust Company's answer to it.

The original intervening petition of the Southern Company was filed in February, 1905, by consent, evidenced by stipulation of parties (Rec. 164, 165). There is nothing in the record to indicate that the issues made on this intervening petition were referred to the master. The amended intervening petition of the Southern Company was filed on May 1, 1905 (Rec. 269), by stipulation (Rec. 267), which, after providing for the filing of the amended intervening petition, proceeds as follows:

> And the Guardian Trust Company *consents* that the issues so made shall be referred to Shannon C. Douglas, Special Master.

The order of the court made on May 1, 1905, in accordance with the stipulation, *and O. K'd by counsel for the Trust Company*, is as follows (Rec. 268):

> In accordance with the *stipulation of the parties herein filed* it is ordered that the intervenor, The Kansas City Southern Railway Company, have leave to file its amended intervening petition and that *the issues made therein* stand referred to Hon. Shannon C. Douglas to take the testimony and report his *findings of fact and conclusions of law* therein with all convenient speed; that the defendants to said amended petition shall have fifteen days from this date within which to file answer. (Signed) SMITH MCPHERSON, *Judge.*
>
> O. K.
>
> J. C. ROSENBERGER,
> H. S. MCCARTNEY,
> *For Guardian Trust Co.*

The issues of fact and law arising under the intervening petition, which are the only issues for determination by this court, were thus referred to the master *by consent of parties.* The parties assented not only to the reference to Hon. Shannon C. Douglas, as special master, but also consented that he should hear and determine the *entire case*, and make his "findings of fact and conclusions of law" upon *all* the issues.

While it may not be of controlling importance it is worthy of note that the issue of debt or no debt, between the Belt Company and the Trust Company, was also referred to the same master by consent, as will appear from the following references to the record:

On April 7, 1905, the amended and supplemental bill of the Belt Company and its receivers was filed by leave of court and the order permitting it to be filed, *which was O. K'd by counsel for the Trust Company* (Rec. 266), provides that when filed,

> the same shall stand referred to Hon. Shannon C. Douglas, special master, with authority to settle the issues and complete the taking of testimony and make *his findings of fact and conclusions of law thereon* with all convenient speed.

After the testimony was closed both parties filed amended pleadings to conform to the proof and it was agreed by stipulation (Rec. 468) that these should "stand referred without further order to Hon. Shannon C. Douglas."

After the filing of the Cambria bill on September 6, 1900, and before the issues were made, the court appointed Shannon C. Douglas, Special Master (Rec. 94), "before whom any testimony herein may be taken," limited to the application of complainant for a temporary injunction. This order does not appear to have been made by consent, but it did not cover, or purport to cover the issues of debt, or no debt between the Belt Company and the Trust Company. That issue was not made until the filing of the bill of the Belt Company and its receivers (Rec. 97). The record does not disclose any order of reference made upon the filing of this bill. It may be noted, however, that this bill was filed by stipulation (Rec. 890), and that the Trust Company's answer to it was filed out of time by stipulation (Rec. 114).

In this connection we desire to correct a statement in the first opinion of the court of appeals in this case (201 Fed. 825), where it is said:

> As before stated the main issues, *and the issues involved on this appeal*, had been referred to the master by the court upon its own motion.

This is wholly erroneous. There is not in the record any order referring to the master the "issues involved on this appeal," except the consent order above quoted.

The court continues:

> The stipulation that the new issue made by the amended intervening petition should be referred to the master was a stipulation with reference to that issue, that issue was decided by the master in favor of the Trust Company, and is not before us for review.

This is equally erroneous. The "issues so made" (Rec. 267), that is, *by the amended intervening petition*, are by consent referred to the master. The record discloses no previous order referring the original intervening petition to the master, and the court's assumption that only the new matter brought in by the amendment was referred by consent is not only inconsistent with the plain meaning of the stipulation (Rec. 267), but is utterly refuted by the order made by the court, *O. K'd by counsel for the Trust Company* (Rec. 268), quoted above, which after referring to the amended intervening petition provides that the "issues made there-

in" that is, by the amended intervening petition, stand referred to the master, to state his "findings of fact and conclusions of law."

The presumption is that the reference was by consent, since the court would have had no authority to refer the entire case to the master *except by consent.* (Vol. 2, Street's Federal Equity Practice, Sec. 1406).

In *Kimberly* v. *Arms,* 129 U. S. 524, it is said:

> It is not within the general province of a master to pass upon *all* the issues in an equity case, *nor is it competent for the court to refer the entire decision of a case to him without the consent of the parties.*

The master did, in fact, pass upon all the issues in the case, both of fact and of law; and none of the parties objected that he was not authorized so to do by the order of his appointment, and none made that the ground of an exception. If the order of reference of the entire case was not by consent of parties the court should have stricken out the report as unauthorized. (*Walker* v. *Kinnare,* 76 Fed., 106; *Garinger* v. *Palmer,* 126 Fed., 906, 911).

The reference to the master having been by consent of parties, the legal consequences which flow therefrom are well established and may be briefly stated with a reference to the decisions of this and other courts.

A reference by *consent* to a special master of a cause in equity to report his findings of fact, *and also his conclusions of law,* is in the nature of a submission to arbitration, and his determination of those questions, may not be "set aside and disregarded at the mere discretion of the court." They are presumptively correct, and can only be set aside "when there has been manifest error in the consideration given to the evidence or in the application of the law, but not otherwise." The rule that only such matters of fact or of law as are duly excepted to will be considered by the lower court, or upon appeal, is applied in all its strictness.

In *Kimberly* v. *Arms,* 129 U. S., 512, 524, it is said:

> It is not within the general province of a master to pass upon all the issues in an equity case, nor is it competent for the court to refer the entire decision of a case to him without the consent of the parties. It cannot, of its own motion, or upon the request of one party, abdicate its duty to determine by its own judgment the controversy presented, and devolve

that duty upon any of its officers. But when the parties consent to the reference of a case to a master or other officer to hear and decide all the issues therein, and report his findings, both of fact and of law, and such reference is entered as a rule of the court, the master is clothed with very different powers from those which he exercises upon ordinary references, without such consent; and his determinations are not subject to be set aside and disregarded at the mere discretion of the court. A reference by consent of parties of an entire case for the determination of all its issues, though not strictly a submission of the controversy to arbitration—a proceeding which is governed by special rules—is a submission of the controversy to a tribunal of the parties' own selection, to be governed in its conduct by the ordinary rules applicable to the administration of justice in tribunals established by law. Its findings, like those of an independent tribunal, are to be taken as presumptively correct, subject, indeed, to be reviewed under the reservation contained in the consent and order of the court, when there has been manifest error in the consideration given to the evidence, or in the application of the law, but not otherwise.

The language of the court in *Moline Plow Company* v. *Carson*, 72 Fed., 387-388, is especially applicable to the case under consideration:

> The special master, upon whose report the decree in this suit is based, was appointed by consent of the parties, not to hear and report the evidence, but to report the facts and the law in this case. The parties to this suit selected him and made him a special tribunal to hear and decide this suit. His report has been confirmed by the court below, and it carries with it similar presumptions to those which accompany the special verdict of a jury or the special findings of a court in an action at law, or its decree in a suit in equity. The settled rule of the national courts is this: The findings of fact and conclusions of law contained in the confirmed report of a special master appointed by consent of the parties to the suit to report the facts and the law are conclusive, unless an obvious error has intervened in the application of the law, or some serious or important mistake has been made in the consideration of the evidence.

The order of reference in the case under consideration was to "Hon. Shannon C. Douglass" without further designation. Under similar circumstances, the United States circuit court of appeals for the fourth circuit in *Westall* v. *Avery*, 171 Fed., 626, held

that the person named was thereby constituted the arbitrator, and that his findings were conclusive upon all parties, unless they should be set aside for fraud, misconduct, or other well settled legal reasons. There the reference was by consent made by the parties in open court, as follows:

> Said case and all other issues arising upon the pleadings be, and the same are now hereby referred to A. Burwell, Esq., who will take and state the evidence and his conclusions of law and fact thereon to the next term of this court for further action of the court.

The court said:

> It will be perceived that this reference was not to Burwell as either a referee or master of the court, nor did the order constitute him a special master *pro haec vice*. The whole case was referred to him as a private individual and gave him power to "conclude" as to both the law and the facts involved. He was to report his conclusion to the court, it is true, "for further action of the court." What further action by the court was contemplated? Was it any other or further than that usual in cases of arbitration where the award is provided to be entered up as the judgment of the court *unless it should be properly assailed and set aside, for fraud, misconduct, or other well settled legal reasons?* We think not. On the contrary, it was, at least, fully within the scope of the ruling in *Kimberly* v. *Arms*, 129 U. S., 512, 9 Sup. Ct. 355, 32 L. Ed. 764, where, by consent, a special master was constituted to "hear the evidence and decide all issues between the parties and make his report to this court, which report shall be subject to like exceptions as other reports of masters." In that case, notwithstanding the last provision subjecting the special master's report to "exceptions as other reports of masters," it was held: "It is not within the general province of a master to pass upon all the issues in an equity case, and the court cannot refer to him the entire decision of a case without the consent of the parties; but when the parties consent to a reference of a case to a master to hear and decide all the issues therein, and such reference is entered as a rule of the court, his findings cannot be disregarded at the mere discretion of the court, but are to be taken as presumptively correct —subject, however, to be reviewed under the reservation contained in the order of the court for manifest error."

The court of appeals for the fifth circuit, (*Farrar* v. *Bernheim*, 75 Fed., 136) says:

It is, moreover, true, as insisted by the appellee, that, under the written consent to refer all questions of law and fact to the determination of a particular standing master the finding of that officer is usually conclusive. Such a consent, entered as an order of the court, is a submission of the controversy to a special tribunal selected by the parties, to be governed by the ordinary rules applicable to the administration of justice in tribunals established by law; and its determinations are not subject to be set aside and disregarded at the mere discretion of the court. *Kimberly* v. *Arms*, 129 U. S., 512, 9 Sup. Ct. 355. Such findings may be avoided, however, *on exceptions* showing that the report is unsupported, or essentially defective, *but not otherwise.*

The court of appeals for the sixth circuit (*Sanford* v. *Embry*, 151 Fed., 977), holds:

> Where a reference was by consent of the parties, and directed the master to report his conclusions of fact and law to the court, the findings of the master will be treated as *prima facie* correct, *and only such matters of law and fact as were brought before the court by exceptions will be reviewed.*

The court of appeals for the seventh circuit, (*Sanders* v. *Village of Riverside*, 118 Fed., 720), holds:

> Where in accordance with a written stipulation of the parties, the whole case is submitted to a master to find both the law and facts, his findings are conclusive on both parties *except so far as they are excepted to.*

To the same effect are:

Dowagiac Mfg. Co. v. *Plow Co.*, 183 Fed., 317;
Brown v. *Lanyon Zinc Co.*, 179 Fed., 311;
Davis v. *Schwartz*, 155 U. S., 631, 637;
Furrer v. *Ferris*, 145 U. S., 132, 134;
Spring Garden Insurance Co. v. *Amusement Syndicate Co.*, 178 Fed., 519, 531.

XVII.

The ruling of the court of appeals, that an exception to the master's report was unnecessary, works a great hardship in this case, and in effect deprives the appellant of its day in court on the question whether there was in fact any debt owing by the Belt Company to the Trust Company.

The Belt Company and its receivers filed their exceptions to the report of the master upon the issue of debt or no debt between the Belt Company and the Trust Company. The Southern Company and the Cambria Company also filed their exceptions (Rec., 913).

These exceptions were overruled by the lower court and the question of taking an appeal was then presented. The Trust Company's exceptions had only asserted that the master erred in *including* in his report any "reference to or recommendation concerning" the liability issue. The purpose of its appeal, as disclosed by its assignments of error, as well as by its exceptions to the master's report, was to *eliminate* from the decree any reference to or recommendation concerning the liability issue. It carefully avoided taking any step in the lower court, or in the court of appeals, which in any way invited or permitted a decision upon the *correctness* of the master's conclusion that the Southern Company was not liable for the debt of the Belt Company. Its deliberate purpose was to *prevent* a decision of that question in this case so that it might be determined in the State court in the actions there pending. And so the matter stood *until long after the right of appeal by its adversaries had been lost by lapse of time.*

In these circumstances the Belt Company and its receivers, as well as the Southern Company and the Cambria Company, believing that the liability issue was properly in the case—and the subsequent decision of the court of appeals confirmed this view—that being the only question raised by the appeal, (except the ownership of the property of the Central Company, and the taxation of costs), confidently believed that the decree of the lower court on the liability issue would be affirmed, as in fact it would have been if the court of appeals had not permitted the Trust Company, *in ef-*

fect, to file exceptions to the master's report more than a year after the report had been filed, and, *in effect,* to retake its appeal after the time for an appeal had long since passed by.

The adversaries of the Trust Company, in view of these circumstances, took no appeal upon the question of the existence or amount of indebtedness between the Trust Company and the Belt Company, or upon the other issues where the decision of the lower court was adverse to them. It was *long after the time for an appeal from the decree,* which was rendered on June 25, 1910, *had elapsed* that the court of appeals, in October, 1912, not only held that the liability issue *could be* considered by it, notwithstanding the state of the record, and notwithstanding the solemn protest of the Trust Company that the liability issue was not in the case and could not be decided (Rec., 970), but also proceeded to decide that issue adversely to the Southern Company, *thus virtually reversing the lower court for overruling an exception that was never filed,* and permitting the Trust Company, in effect, to *refile* its exceptions and to *retake* its appeal, while no such right could be enjoyed by its adversaries.

With our right of appeal lost through a reliance upon the protest of the Trust Company that it sought not to challenge the *correctness* of the master's finding, but only to insist that that issue should be *eliminated* from the case, as well as through a belief that the Trust Company in the court of appeals would be confined to the appeal taken by it in the lower court, in accordance with established principles, we are now confronted with the statement, several times repeated in the second opinion of the court of appeals, that the bill of the Cambria Company (which by stipulation was heard on the same evidence and contained substantially the same allegations as the bill of the Belt Company) was "baseless" and "untrue" and an "unwarranted suit."

This serves to emphasize our insistence that we have been deprived of our day in court, for not only were we deprived of the right of appeal by a reversal of the ordinary course of appellate procedure, but the case of the Cambria Company and of the Belt Company are condemned as baseless, unwarranted and un-

true by an appellate court that has not had before it any one of the "tens of thousands of pages of testimony," (to use the court's own language), on which the case was heard below.

We respectfully submit that the decree of the court of appeals should be reversed and that the decree of the circuit court should be affirmed.

SAMUEL UNTERMYER,
SAMUEL W. MOORE,
Solicitors for Appellant and Petitioner.

October, 1915.

No. 341.

Office Supreme Court, U. S.
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CLERK

Supreme Court of the United States

THE KANSAS CITY SOUTHERN RAILWAY COMPANY,
Petitioner,

against

GUARDIAN TRUST COMPANY,
Respondent.

THE KANSAS CITY SOUTHERN RAILWAY COMPANY,
Petitioner,

against

CENTRAL IMPROVEMENT COMPANY,
Respondent.

Reply Brief of The Kansas City Southern Railway Company in Support of its Petition for Certiorari.

SAMUEL UNTERMYER,
SAMUEL W. MOORE,
Solicitors for Petitioner.

B. H. TYRREL, PRINTER, 206-8 FULTON STREET, NEW YORK.

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REPLY BRIEF OF THE KANSAS CITY SOUTHERN RAILWAY COMPANY IN SUPPORT OF ITS PETITION FOR CERTIORARI.

I.

The Trust Company in its brief has wholly evaded the controlling issue of estoppel, tendered by the Petitioner's Brief.

The *main ground* of our application for certiorari is that the Trust Company is estopped by

its participation in the reorganization, which is the fundamental ground of distinction between this case and the Boyd case.

The Court of Appeals held that there was no estoppel *in pais,* because the four essential elements were absent. *We never claimed that there was an estoppel in pais.* We strenuously claimed at all times that there was an estoppel by election and by acceptance of benefits, *and this claim was not answered or even noticed by the Court of Appeals.*

It was to be expected that the Trust Company, in its answer to our application, would at least *attempt,* in some way, to meet this controlling issue, since it is the main ground of our application, and a large number of well considered authorities are cited in our brief which have, we believe, a direct and decisive application to the situation.

But counsel for the Trust Company apparently have not thought it advisable to meet the issue squarely. Certainly they have presented no argument and cited no authority in opposition to our contention that, if the reorganization was fraudulent in law as the Court of Appeals held that it was, the Trust Company, by its participation therein and the acceptance and retention of benefits thereunder, is estopped to maintain its action.

Counsel content themselves with the following extraordinary assertion which finds no support in the record and is in fact in direct conflict with the entire theory of the decision:

> "The plan is conceded to be honest and fair upon its face, and the Trust Company is held to be entitled to the relief of one de-

frauded because in the execution of the plan its debt was not paid."

What is meant by this ambiguous statement?

Does it mean that the charge of fraud in fact or in law in the plan and its execution is withdrawn? If so, the opinion of the Court of Appeals is robbed of its support and its judgment must fall to the ground.

Does it mean that the plan and its execution diverted to stockholders assets which should have gone to creditors, so as to constitute a fraud in law? If so, the plan and the transfer of the Belt property, in the language of this Court in the Boyd case, were "proper and binding as between the parties" and the Trust Company cannot complain.

Does it mean that the plan was valid on its face, but that it became a fraudulent device when the Trust Company's debt was not paid? If so, the retention of the fruits of the transaction, after it became fraudulent, or after the fraud was discovered, is equally as conclusive as though the fraud existed and was known in the beginning.

But no amount of evasive argument can obscure the real and controlling issues:

(a) The decision of the Court of Appeals was distinctly based upon the assumption that the plan and the transfer of the Belt property was a fraud in law, either at the beginning or afterwards. In both opinions the transaction is variously denominated as "fraudulent in law", "fraudulent and voidable as to creditors", "a fraudulent appropriation of the Trust Company's equity to the benefit of the stockholder or stockholders", "illegal and fraudulent as to creditors", "fraudu-

lent and voidable as to them (creditors)", "a transfer fraudulent as to creditors," "the fraud and breach of trust which made the transfer voidable as to creditors", etc.

The decisions upon which both opinions are based are the *Monon* case (174 U. S., 674), the *Howard* case (74 U. S., 392), the *Paul* case (93 Fed., 878), the *Boyd* case (177 Fed., 804; 228 U. S., 482), the *Lueäecke* case (140 Ia., 223), and the *Hurd* case (60 N. E., 327).

These are all cases in which the sole ground of recovery was that the reorganization was a fraud upon unsecured creditors. Counsel impliedly admit that this is so, when they say, at page 8, referring to the decision of the Court of Appeals in this case:

> "The decision consists merely in the application of the well established doctrine that any scheme or device whereby the interests of the stockholders are preserved at the expense of the creditors comes within judicial denunciation."

The sole foundation on which the judgment of the Court of Appeals rests is the doctrine of a fraudulent conveyance or diversion to stockholders of assets which in equity belong to creditors.

(b) To the action thus based upon the theory of a fraudulent conveyance, we answer that the Trust Company *participated* in the transaction, became a *party* to it, received and still *retains*, large benefits from it, and that, therefore, it is *estopped* to complain.

In answer to this proposition counsel are content to point to the opinion of the Court of Appeals, with the ambiguous and unsatisfactory sug-

gestion that the Trust Company is "entitled to the relief of one defrauded, because in the execution of the plan its debt was not paid."

We insist that the Trust Company has not met the issue or even attempted to do so.

II.

The floating debt provision in the plan of reorganization was not a factor in the determination of this case.

The brief of the Trust Company contains certain statements of fact which we cannot permit to pass unchallenged.

Counsel in their brief give prominence to the following statement:

> "The plan contained the provision that one of the objects to be attained by its execution was the payment of the floating debt. It is by ignoring and suppressing this fact that any semblance of plausibility is given to the petitioner's argument."

If it is sought by this statement to create the impression that the judgment of the Court of Appeals was *based* upon the floating debt provision, or that that provision was a *controlling factor, it is misleading and without foundation in fact.* There is nothing in the record from which the Trust Co. is justified in asserting or suggesting that the Southern Company assumed or undertook

the payment of the entire floating debt of the insolvent companies that were the subject matter of the plan. The statement in the plan had reference only to a tentative appropriation of $475,000 toward that purpose, as plainly appears from the subsequent provisions of the plan.

By the express provision of the plan referred to (Rec., 944, 951) there was an estimate or tentative appropriation of $475,000 for the payment of the floating debt of *all* the Companies involved in the reorganization. The floating debt of the Belt Company *alone* was $990,000 (Rec., 873), as the Trust Company well knew. The Southern Company and the Reorganization Committee actually paid $1,164,172.56 (Rec., 999) of the floating debt of all the companies, for the purpose of discharging underlying liens and making the new mortgage a first lien upon all the properties (Rec., 999, 1000).

The Trust Company contended in the Circuit Court and also in the Court of Appeals that the floating debt provision was a contract for the benefit of creditors, and that, therefore, it could recover directly upon the contract. The Master (Rec., 1001) found against this claim and the lower Court agreed with him. The Court of Appeals likewise refused to sustain this contention of the Trust Company. In its first opinion, in answer to our claim that the Trust Company by its exchange of securities was estopped to maintain its action, the Court of Appeals said (Rec., 1177), referring to the floating debt provision of the plan: "The Trust Company may well have *supposed* that its claim would be paid by the Committee." But this position was abandoned in the second opinion, and, as the opinion itself shows, no significance

whatever was attached to the floating debt provision. Much less was it held that a right of recovery could be based thereon.

The decision of the Court of Appeals is placed solely upon the ground that the plan was "fraudulent in law" either in its inception, or afterwards in its execution, as a fraudulent conveyance to stockholders of property which should have gone to creditors. The floating debt provision was not a factor in the determination of the case. This was necessarily so under the decisions of this and other courts. The floating debt provision was obviously either decisive of the case, or without any significance whatsoever. The Court adopted the latter alternative.

III.

There is no basis whatever for the extraordinary statement that the entire floating debt of the constituent companies has been paid, except the debt of the Trust Company.

Counsel make the amazing assertion on page 3 of their brief that: "The floating debt of all the constituent companies was paid by the Reorganization Committee or by the Southern Railway, with the exception of the Trust Company's debt."

We deeply regret to be compelled to say that there is not a syllable of testimony in the entire record to support this statement, or from which any such inference can be drawn or which furnishes any excuse for the statement.

The same statement is repeated on page 6 of the brief, as the alleged reason why "equitable terms," as of the date of reorganization, should not be the measure of the Trust Company's rights, if it is entitled to recover at all.

We are at a loss to understand why counsel should make and repeat such statements, unless the purpose was to create the misleading impression in the minds of the Court that the Trust Company has been a victim of discrimination or hostility, and that it has been singled out for unfair treatment.

Most emphatically this is not the case. There has been no discrimination and no favoritism, of any kind, whatsoever.

IV.

The Trust Company misconceives the effect of the covenant which it executed to the effect that it would not hold the new company for the debts of the old company.

It is argued that the adoption of our construction of the covenant would lead to a "preposterous conclusion," as it would require the Trust Company to "renounce and waive" a just claim against the Belt Company as a condition to becoming a party to the reorganization.

No such result follows. The plan did not require the Trust Company to "waive or renounce" its claim against the Belt Company. It provided that no *new right* for the enforcement of this

claim should be *created* against the new company which was to be organized.

The covenant said, in substance, to the Trust Company:

> Accept or reject the plan at your election. If you come in you will be accorded rights in the new company in exchange for your old stocks and bonds, which you would not receive but for the plan. You may retain your claim as a creditor of the Belt Company, but no new right of action will be *created* for its payment by the new company.

All stockholders and bondholders were given the same election. There was nothing unjust or "absurd" in the covenant, and there is no reason why effect should not be given to its obvious terms.

V.

The amount of the assessment paid by the stockholders of the Gulf Company is not competent evidence to overthrow the Master's finding as to the value of the Belt property.

That there was no equity in the Belt property and that the Trust Company has not been prejudiced, is argued in our brief in support of our application (pp. 28-35).

It is now asserted that the Circuit Court of Appeals found "convincing evidence" that the value of the Belt property received by its stockholders

far exceeded the amount of the Trust Company's debt.

The Court of Appeals reaches the conclusion that the $4,750,000 par value of Southern stock, which was issued in exchange for an equal amount, par value, of Belt stock, was of the value, at least, of $10 per share, making an aggregate of $475,000, and the Court argues that, therefore, the stockholders of the Belt Company received that much in value which should have gone to creditors, notwithstanding the finding of the Master (Rec. 990, 991), that the fair value of the Belt property was $1,000,000, which was the exact amount of the mortgage debt, and the exact amount for which it was sold at foreclosure sale, leaving nothing for either creditors or stockholders. It will be recalled in this connection that the evidence was not before the Court and that there was no exception to this finding by the master.

The Court of Appeals deduces this value of $10 per share of stock of the Southern Company from the fact that that was the amount of the *assessment* made by the plan on the stockholders of the Gulf Company.

But this assessment was a *condition of participation* in the plan by the stockholders of the Gulf Company. They had the option to lose all they had invested in their stock, or to pay the assessment. It was far from being a *sale* of Southern stock, much less a sale which could be looked to as a criterion of the *value* of the stock.

VI.

The debt of the Trust Company is not conceded to be a just obligation of the Belt Company. It certainly has never been conceded to be an obligation of the Southern Company as is implied in the brief of the Trust Company.

It is stated at page 9, that the debt of the Trust Company "is now conceded to be a just one." This is not correct.

As stated in our original brief, exceptions were filed to the finding of the Master on the question of debt as between the Trust Company and the Belt Company. At the same time the Trust Company filed exceptions to the *inclusion* in the Master's report of *any* finding on the liability of the Southern Company for this debt. All exceptions were overruled, and the Trust Company appealed, for the purpose of *eliminating* any finding from the decree on the liability issue, *not* for the purpose of reviewing the finding on the merits of the issue. Having a decree in our favor on the liability issue, and the appeal not questioning the *correctness* of that part of the decree, no appeal was taken on the accounting feature between the Belt Company and the Trust Company, for the obvious reason that, *under such circumstances*, the question of debt or no debt was of little consequence. In the Court of Appeals the Trust Company said in one of the papers filed in that Court (Rec., 1146):

> *"The question of the personal liability of The Kansas City Southern Railway Company for the debt of the Belt Company is*

not an issue and cannot be determined on this appeal."

Notwithstanding this declaration, the Court of Appeals decided that the liability issue *was* in the case, and proceeded to decide it adversely to us, *after the time for an appeal on the issue of debt or no debt had expired.*

We were thus prevented from taking an appeal, and the finding and judgment as between the Belt Company and the Trust Company have thus become final, but it is not fair to say that it is conceded that the debt is a just one.

VII.

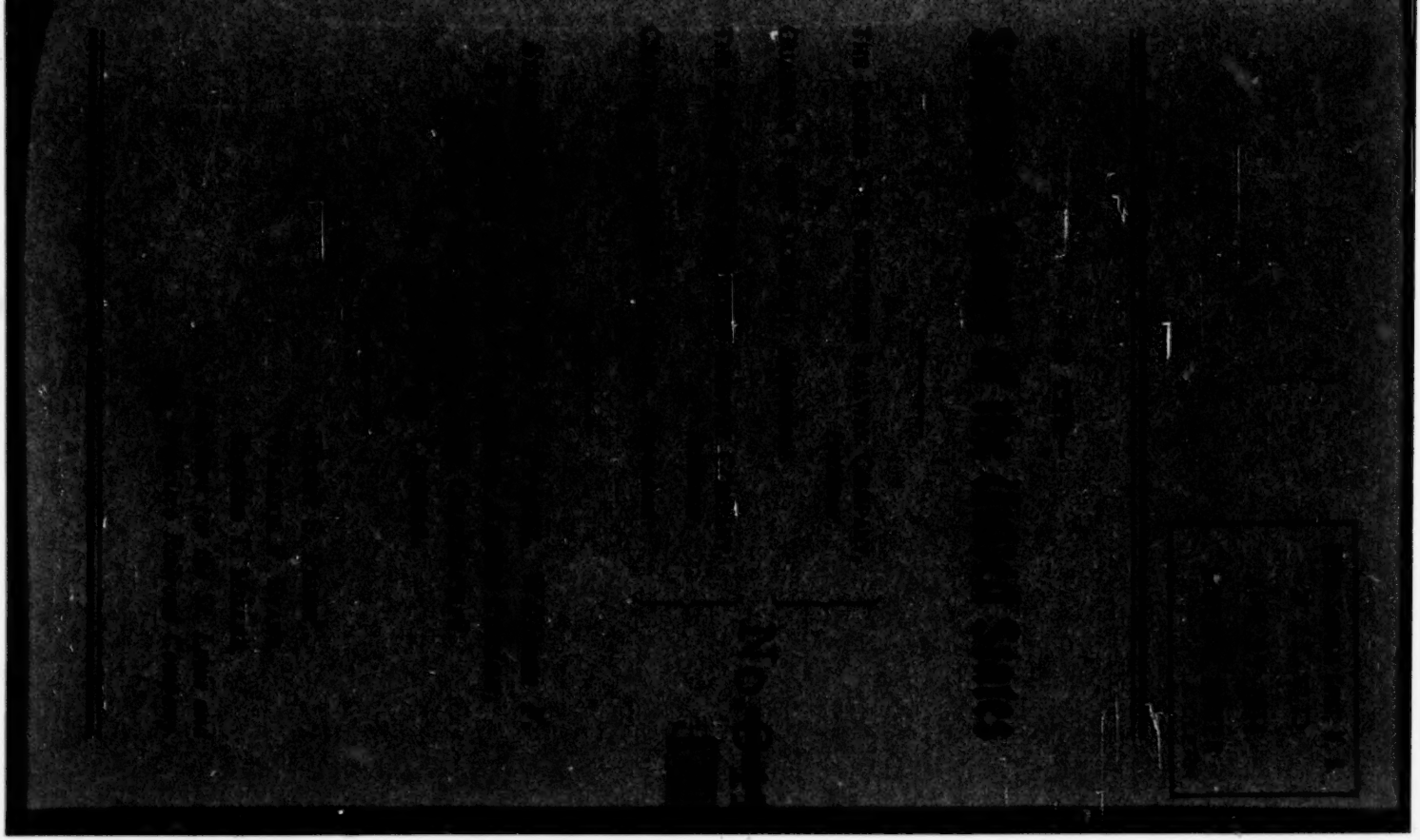
The assertion that the Southern Company has had its day in this Court is devoid of merit.

This claim is based upon the fact that one of the counsel for the Southern Company filed a brief as *amicus curiae* in the *Boyd* case, raising the question whether, if Boyd had any remedy, it was not by action against the stockholders who, it was alleged, had received something of value which should have gone to creditors.

Neither that question, nor any of the questions argued and decided in the Boyd case, are raised in our application for certiorari.

Respectfully submitted,

SAMUEL UNTERMYER,
SAMUEL W. MOORE,
Solicitors for Petitioner.



—IN THE—

Supreme Court of the United States

THE KANSAS CITY SOUTHERN RAILWAY COMPANY, *Petitioner*,
vs.
GUARDIAN TRUST COMPANY, *Respondent*.

THE KANSAS CITY SOUTHERN RAILWAY COMPANY, *Petitioner*,
vs.
CENTRAL IMPROVEMENT COMPANY, *Respondent*.

Suggestions of Henry S. Priest, William F. Evans and Edward T. Miller, Amici Curiae, Upon the Petition for Certiorari in the Above Causes.

The undersigned practitioners in this Court, Henry S. Priest, William F. Evans and Edward T. Miller, of the City of St. Louis, Missouri, present these suggestions, *amici curiae*, and thereupon they respectfully say:

1. The St. Louis and San Francisco Railroad Company is now in the hands of receivers appointed in a cause instituted on creditors' bill on May 27, 1913, in the District Court of the United States for the Eastern Division of the Eastern District of Missouri.

2. The lines of certain affiliated companies of said St. Louis and San Francisco Railroad Company, forming in part the system of railroads known as the "Frisco Lines," are also in the hands of

receivers, the names of said companies and the respective courts in which such receiverships are pending, being as follows:

New Orleans, Texas and Mexico Railroad Company, in the United States District Court for the Eastern District of Louisiana;

The Brownwood North and South Railway Company, in the United States District Court for the Northern District of Texas;

Fort Worth and Rio Grande Railway Company, in the United States District Court for the Northern District of Texas;

St. Louis, San Francisco and Texas Railway Company, in the United States District Court for the Northern District of Texas;

The Beaumont, Sour Lake and Western Railway Company, in the United States District Court for the Southern District of Texas;

The Orange and Northwestern Railroad Company, in the United States District Court for the Southern District of Texas;

The St. Louis, Brownsville and Mexico Railway Company, in the United States District Court for the Southern District of Texas; and

Chicago and Eastern Illinois Railroad Company, in the United States District Court for the Eastern Division of the Northern District of Illinois.

3. The bonded indebtedness of said St. Louis and San Francisco Railroad Company and of its affiliated companies amounts to many millions of dollars and the outstanding unsecured indebtedness of said companies likewise amounts to many millions of dollars. This secured and unsecured indebtedness is held by numerous parties in various parts of the United States and in foreign countries.

4. Various committees representing bondholders, stockholders and unsecured creditors of said St. Louis and San Francisco Railroad Company and of its affiliated companies have been formed, and for some time have been acting under the advice of their respective counsel for the purpose of protecting the various interests represented by them in the proposed reorganization of said railroad companies.

The names of said committees, the interests by them represented, and their counsel, are as follows:

(a) A committee, consisting of Speyer and Company, representing the holders of St. Louis and San Francisco Railroad Company's General Lien 15-20 year 5 per cent. Gold Bonds, to which committee Messrs. Cravath and Henderson and Messrs. Strong and Cadwalader, of New York City, are counsel.

(b) A committee, of which Henry E. Cooper is chairman, representing the holders of St. Louis and San Francisco Railroad Company's $2,600,000 two-year 6 per cent. Secured Gold Notes due September 1, 1914, to which committee Messrs. Murray, Prentice and Howland, of New York City, are counsel.

(c) A committee, of which Frederick Strauss is chairman, representing the holders of St. Louis and San Francisco Railroad Company's 4 per cent. Refunding Mortgage Gold Bonds, to which committee Messrs. Joline, Larkin and Rathbone, of New York City, are counsel.

(d) A committee, of which Willard V. King is chairman, representing holders of St. Louis and San Francisco Railroad Company's New Orleans, Texas and Mexico Division First Mortgage Gold Bonds, to which committee Messrs. Carter, Ledyard and Milburn, of New York City, are counsel.

(e) A committee, of which E. S. Page is chairman, representing holders of Ozark and Cherokee Central Railway

Company's First Mortgage 5 per cent. Gold Bonds, to which committee Messrs. Roberts, Montgomery and McKeehan, of Philadelphia, are counsel.

(f) A committee, of which E. V. R. Thayer is chairman, representing holders of Kansas City, Fort Scott and Memphis Railroad Company's Consolidated 6 per cent. Bonds; The Kansas City, Fort Scott and Memphis Railway Company's Refunding 4 per cent. Bonds; Kansas City, Memphis and Birmingham Railroad Company's Income 5 per cent. Bonds; Kansas City, Memphis and Birmingham Railroad Company's General 4 per cent. Bonds; Kansas City and Memphis Railway and Bridge Company's First 5 per cent. Bonds; Kansas and Missouri Railroad Company's First 5 per cent. Bonds; Current River Railroad Company's First 5 per cent. Bonds; and Trust Certificates for Guaranteed 4 per cent. Preferred Stock of The Kansas City, Fort Scott and Memphis Railway Company, to which committee Messrs. Storey, Thorndike, Palmer and Dodge are counsel.

(g) A committee, of which John W. Patten is chairman, representing holders of New Orleans, Mobile and Chicago Railroad Company's First and Refunding Mortgage 5 per cent. Gold Bonds, to which committee Messrs. Beekman, Menken and Griscom, of New York City, are counsel.

(h) A committee, of which Alvin W. Krech is chairman, representing holders of St. Louis and San Francisco Railroad Company's Trust Certificates for preferred and common stock of Chicago and Eastern Illinois Railroad Company, to which committee Messrs. Murray, Prentice and Howland, of New York City, are counsel.

5. It is essential that the various railroads hereinbefore referred to now in the hands of receivers, be reorganized and placed upon a sound financial basis, and it is important that there be no doubt as to the legality of any such reorganizaton. The opinion of the Circuit Court of Appeals for the Eighth Circuit, in the Guar-

dian Trust Company case, has given to the case of *Northern Pacific Railway Company* v. *Boyd*, 228 U. S., 482, a construction which, in our opinion, the Boyd case does not authorize, and which materially enlarges and extends the force and effect of the judgment of this Court in the latter case. The questions involved in the Boyd case and in the Guardian Trust Company case are questions entering as vital factors in the proposed reorganization plans of the various committees herein referred to.

6. In order that much litigation affecting the legality of the proposed reorganizations may be avoided, and that the misunderstanding existing respecting the scope and effect of the ruling of this Court in the Boyd case be removed, and believing it to be the great interest of the public at large and for the protection of those purchasing railroad securities, we respectfully suggest that this Court should take jurisdiction of the Guardian Trust Company case in order that the questions involved therein may be definitely settled.

Respectively submitted:

HENRY S. PRIEST,
WILLIAM F. EVANS,
EDWARD T. MILLER,
Solicitors for the St. Louis and San Francisco Railroad Company.